THE ROAD AHEAD

A Review of the Annual Conference
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PREFACE

Among the persistent problems of business management are the problems of maintaining adequate control of current operations without hampering them and without sacrificing too much time, and the problem of developing balanced, flexible plans for the future. Good, adequate budgeting provides the best means yet devised of accomplishing both control of current operations and coordinated, scientific planning for the future — planning for profits.

Properly used budgetary control gives to foresight some of the advantages of hindsight not otherwise possible. If business planning is done wisely and flexibly with full knowledge of the effects of decisions on the operations, it contributes significantly to the continuing stability of the enterprise. To the extent that this situation is common throughout industry, the economy of the country itself will be strengthened.

The purpose of the National Society for Business Budgeting is to improve the techniques and increase the effectiveness and competence of those engaged in this phase of management. In addition to the regular chapter meetings, the society is engaged in research projects, both independently and in cooperation with several well known universities. These projects are designed to make budgetary control more effective, to increase its use by businesses of all sizes and types, and to develop simple and practical techniques.

The theme of this second annual conference of the National Society for Business Budgeting, "The Road Ahead," emphasizes the factors involved in planning and budgetary control under today's conditions. Eminently qualified men representing divergent aspects of American business gave excellent papers and led in outstanding discussions which probed deeply into the economic and technical problems, made very useful suggestions, and frequently illustrated their points with actual examples. The material will serve as a reminder of the ideas expressed to those who had the privilege of attending and, we hope, will be stimulating and provocative to those who were not there.

Walter R. Bunge
President (1951-52)

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CONFERENCE OPENING

George A. Kolman
General Chairman

Good morning.

On behalf of the National Society for Business Budgeting, it is my happy privilege to welcome you, ladies and gentlemen, to this, our second annual conference.

Our National Conference Committee has worked very hard for the past five months trying to put together a program which we hope you will find stimulating and leave you feeling it was worth your while to take the time away from your desks.

Compared with other organizations, our society is still in its infancy. However, we are proud of the progress we have made in approximately six years. We believe we are a little different than most organizations in that we limit the membership in our individual chapters. We try not to exceed 50 to 60 members. This is done deliberately to preserve the forum type of meeting--the type of meeting where men sit around a table and have ample opportunity to discuss their problems. Limiting our membership, strictly adhering to the standards we have set up for qualifying for membership has worked out very well. We, of course, do not limit number of chapters. For example, there is no reason why a large city like New York can't have two or more chapters.

Those of you who are interested in learning more about our society can get whatever information you want at the information desk located in the foyer; or if we don't have it, tell us what it is, leave your name and address, and we will get it to you.

We feel the progress we have made is largely due to the soundness of the basic principles the founders had in mind when they decided to create our organization. Our concept of budgeting is that it is nothing more or less than the day-to-day planning that takes place in every business. We believe that, regardless of whether it is the president or the foreman of the smallest unit in a plant, each to be successful, must make plans and then daily control the various elements of the plan. Yes, we believe that budgets are day-to-day plans converted into dollars. Unfortunately, too many business executives still think of budgets as being something separate and apart from their daily operations. It wasn't too long ago that I heard a man in a very important position in his company say, "Let's get the budgets out of the way and get back to making our product." This statement reflects complete lack of understanding of what the budget really is, how it helps to coordinate, control and obtain the objective of a business.

Our concept of budgeting also includes the basic principle that budgets properly established build men and permit management by exception. By management by exception, we mean that once a man's plans are approved, he can operate without running to his boss every five minutes for approval of each individual action. The only time he needs to go to his boss is when the plans change radically or when it is evident that objectives will not be attained. This, of course, means that the budgeting program must be tailored individually to the needs of each organization, that budgets must be based on sound principles which must be explained from top to bottom of an organization so that everybody understands that the budgets represent

his plans converted into dollars and thus, are an important tool for carrying out responsibilities. This builds morale of an organization. We have the profound conviction that the National Society for Business Budgeting has an opportunity to make an important and valuable contribution to American industry by addressing itself to the task of promoting better understanding of the important part budgeting plays in the vital function of management planning and control.

This has become our guiding principle and we are hopeful that our program today and tomorrow will succeed in explaining this concept in greater detail.

We are very grateful to the speakers who appear on this program. Without their willingness to give not only of their time at this conference, but the hours of preparation that it takes to prepare a talk, a meeting of this sort could not be possible. On behalf of the National Society for Business Budgeting I thank them. Your attendance, I believe is an expression of your appreciation of hearing from these men all of whom, each in his own field, is considered an authority.

My time is up--I'm not supposed to make a speech, so let me close by saying once more we are happy to have you with us and turn this first session over to the permanent chairman of the session, Mr. William Edmonds. Mr. Edmonds is the President of the New York Chapter and Program Chairman for the conference. Bill--the meeting is yours.

INTRODUCTORY REMARKS

William J. Edmonds
Program Chairman

Start here

We are here to discuss the preparation of budgets and their use in the management of a business enterprise. The budget may be defined as the coordinated operating plan, including the explanation and analysis in financial terms. It pulls together and clarifies the ideas and plans of all departments of a business, establishes the financial goals of those plans, and points up the difficulties and problems to be solved in achieving those goals. The budget is a map of "The Road Ahead." The function of the budget man and his associates is to foresee the possible roadblocks and to make sure that his company has a plan to remove them--or to take another and better highway to profits.

The program of the two-day conference parallels in a way the development of the plan in a particular company. This morning we will deal with the economic outlook, how to interpret its impact upon a business; then with capital expenditure plans and long-range market prospects. We will be making a business forecast with particular emphasis on the Road Ahead in the Post-Armament Period.

This afternoon we will discuss "Management of Budgeting and Financial Planning," including the development of the sales program, its coordination with operating and financial plans through the budget, and the attainment of financial objectives.

Tomorrow morning we will bear down more precisely through case studies, on the problem of profit planning and controls at the operating level under conditions where the business outlook may be less favorable, such as we may be facing in the post-armament period.

At our luncheon meetings we will take a look ahead with business leaders.

Examination and discussion of the economic outlook by those participating in making budgets is essential. Each of the NSBB chapters devotes one or more meetings each year to this subject.

In the company, discussion of economic factors at the earliest stage of the planning cycle is desirable. The views of consultants, expressed by outside services as well as by staff economists, are to be taken into account. In some companies, we planners or budgeters have the opportunity, after consultation with top management, to build a program based on a considered judgment of the economic factors. These discussions between the planners, the doers, and policy makers may not improve the accuracy of a forecast but they do alert management to the possibility of change and the need to be prepared should the course of business change abruptly.

I do hope that as a result of this meeting we will have a broader appreciation of the important economic factors which can have a major influence on our own company's sales, operating cost and financial position.

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THE ECONOMIC OUTLOOK

Current and Post-Armament Prospects

ECONOMIC FACTORS IN BUSINESS PLANNING

Dr. Charles A. Bliss
Professor of Business Administration
Harvard Business School

I have been asked to talk this morning about the economic factors that have to be considered in making business budgets. It seems appropriate to talk about this topic for both the short run and the longer term.

Someone has described our present situation as a mixture of many elements and specifically as a situation marked by guns, butter and unemployment. The real nub of the question is how the changes in these three elements are going to affect us. It seems to me "guns" is the most important factor for us to consider. You'll remember in World War II guns started first as a trickle, then a flow, and then a flood. We are a long way from having a flood, as you know. That, I think is inevitable in the situation as it stands. There are the difficulties in getting started, the desire to wait for a later model which might be just exactly what is needed, the unwillingness to put too heavy an investment in parts that are apt to be outmoded, and I think on top of that just a sheer impossibility, physically, of getting started when we as individuals don't see much reason for running. It is not the frightening situation we had in the last war. Accordingly, we have the inertia of a standing start to overcome.

It is still true that defense expenditures are very high indeed - at a 48 billion rate. Admittedly, a lot of this defense spending is perhaps unwise, some inefficient, but still the volume of spending that is necessary is very great indeed, and I see no reason why that should not continue for sometime to come. There is the proposal voted by the House for a cash limitation on spending, not procurements, but actual spending on contracts for the next fiscal year. That is still to be, of course, settled by action of the Senate and we may see some lifting of that limit now set at 46 billion. Whether or not this precise limit be imposed, I think we shall see a slippage of quite a bit of defense spending throughout this year and even into next year.

Looking at the overall picture I am one of those who is much impressed by the developments that have taken place in this last decade. This has been a period in which perhaps the production plant has almost doubled. It is a period in which by almost any measure of performance this country has accomplished a tremendous amount in physical terms, despite the tremendous losses of the war years. For example, over

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Editor's Note: In the July-August issue of the Harvard Business Review appears an article by Dr. Bliss entitled Thinking Ahead. In it he states that the discussion is based on his talk before the NSBB which is reproduced here.

a decade ago I heard a statement that the likely prospect of the Federal Reserve index of physical production for the years ahead would be somewhere around 140. Today it is 220, and has been near that high level for more than a year.

If you go back exactly 10 years, as I did the other day, and compare the figures in 1951 - which was not an extraordinary year and for many of you a year of sluggish business - with 1941, which was a year of accelerating defense spending for the country, you will find, I think, a percentage increase in population of around 16%. That is the bench mark to consider in terms of these other figures that I shall cite for you. These figures are dollar figures but an adjustment has been made for the changing value of the dollar and even when that is done we have a level of expenditure for non-durable goods up 29% over a level of 10 years ago. Durable goods were up 50%. In the area of new construction the increase is something like 40%. In the area of services, over 50%. All of these figures, mark you, are contrasted with the change of 16% in the population level. In terms of physical units, expenditures on the productive plant are up over 100%. Much of this obviously is for defense plants, but I think the impact is that in 1951 our economy has been getting a great deal of butter, and in a good many instances some better butter factories as well.

I dwell on these increases in terms of what a decade has shown just to get a pattern for our thinking in terms of what is ahead. We ought not to think of these high levels of the last few years of activity as anything at all like normal. And a decline from these levels should in no measure be thought of a a national calamity or anything of that sort. In fact, we may well ask: Is it not likely, after so long a period of high level activity, that the cupboards of our consumers have been pretty well filled and that we have pretty well stocked up on the things we as customers want to use? If that is so, then what is the prospect from the point of view of ourselves as individual consumers? Despite the implied answers, I'm inclined to think that if there is no collapse in other areas the level of consumer buying will stay up. I hold this view because consumer incomes are high and, although consumers have turned sluggish in buying in recent years, there is a very high level of consumer buying power.

With that in mind, it seems to me that the present situation is not necessarily one for a period of collapse. It is true there are some dark spots on the horizon. We do know that particular industries are spotty; for example, shoes and textiles in New England. I would like to suggest, however, that our economy is stronger because of the adjustments that have taken place. They have brought a partial check on inflation and to the extent of the inventory adjustments in these industries we are better prepared for what lies ahead. We are all acutely aware of the difficulties of selling to individual industries and you in your own industries will have to watch that with care.

There are darker colors and I don't think anyone should ignore them. The present has many of the elements of a tired boom. Profits are down. Inventories are still high in many areas, although working off in others. Goods are in good supply. Capital formation, of which we will hear more later, is going ahead but would seem as though it might well be at peak level. In the light of all this there is some suggestion that perhaps we cannot continue at the levels which we had. I would suggest that the customer is a fickle person and he may well decide not to buy. I also suggest that in this period we have had a whole succession of people forecasting trouble. If you go back 20 years, the old cry has just been reversed. Instead of "Prosperity is just around the corner", in recent years it has been, "Depression is

just around the corner." I don't mean to indicate there is not reason for caution. But I would like to suggest that in a situation where for so long we have been at peak activity, many of those in management have never had experience as responsible officers of working through a period of sharp recession adjustments. What that means you may judge as well as I. There is the risk that our management may be gun shy. They may seek to make quick adjustments, to rush to the other side of the boat at the first sign of trouble. It seems to me that budgeting is of great advantage in that it provides a plan which can be followed. I think we are lucky to have controls which will cause many people to cut back on their purchasing at the very first sign of trouble. Perhaps that is the safe thing to do, but I'm inclined to think that a good many of our inventory adjustments have overadjusted for the trouble. I would suggest to you in your business planning that you watch for signs of dizziness, of vertigo. Perhaps if more cats suffered from vertigo, they wouldn't climb so high and get out on so many limbs, and maybe the same thing is true of business.

Looking ahead to what is beyond the present situation, it seems to me I have already touched on a good many of the factors that will be at work. I would expect defense expenditures to maintain a relatively high pace. The President has indicated the program will carry on into 1954 and I am disposed to think that no matter what change there might be in the administration in Washington and no matter what might happen in Korea, we shall continue to have high defense expenditures.

The sheer task of trying to build up our national defense has so many overwhelming difficulties and problems of timing that I am sure we shall see continued slippages of the program from one year to the next. I only hope the international situation will permit us to do so. I am suggesting that while Russia may well deliberately create situations, short of war but nonetheless designed to irritate us and to embarrass us in the world as a whole, there can be no dropping off of the pressures for us to build up our defense establishments just as strong as we possibly can. Perhaps I am departing in a sense from the topic of the morning with its emphasis on post-armament. I am inclined to think that instead of it being a post-armament period we shall gradually move over into a paler area of partial defense expenditures. Surely, a vastly increased Air Force is not going to be built overnight.

The problem of capital expansion is a very strong element in the immediate picture, and I am sure that that was in the mind of your program planners when they arranged for the second speaker to develop this particular topic at considerable length. For that reason I do not want to spend much time on it, but I would like to propose that even though our plant expenditures have been at high levels, in some situations this expenditure is likely to continue high. Much capital expenditure seems to go along as a cluster movement. One firm starts it and others follow. And in any future period of reduced activity, it will not be the new plant that will be shut down but the older one, because once having been built, the new plant is a low-cost operation. If that be so, then some far-sighted managements might consider it essential for them to build, despite the immediate cost. In other words to survive they may have to spend. And that I think is one reason why once a person starts, it is a problem of keeping up with the Jones' and I think that is probably true in the area of public expenditures as well as in the area of houses.

Others have spoken of the impact of research. I don't need to go into that, but anything that touches research (which is on a very high level now) will have its impact on the rate of new capital expenditures. Anything that disturbs the status quo -- the development of new products, new methods, new ways of doing things, new forms of living, new ways of spending -- all will have their effect on our present

capital structure. And to the extent that takes place, I am sure you will see a necessary adjustment in the plant expansion area. Nonetheless, on balance, I would think that capital formation of producers' goods in the days ahead will show a decline. But I am just as confident we shall see increases elsewhere, particularly in public building and construction.

If we move from the area of formation of capital over into the area of consumer spending (which is going to be covered by the third speaker this morning), I think you will find again some trends that are significant. I urge you, in your analysis, to watch as closely as possible the various factors affecting customers and I would submit that an analysis of national dollar aggregates alone is not the answer. It isn't simply a matter of looking at the level of national spending and saying that much income is in the hands of customers and necessarily the response will be a certain amount. The buying waves that struck us after Korea and again just a little over a year ago, then the shyness of the customer in the months since last summer -- these, I think, are evidence that the customer is a person who has a mind of his own, quite apart from either the Federal Reserve System's dictates or the level of disposable income. For that reason I would urge you to watch the factors that affect the level of his spending. I might just mention a few of the trends, as I see them. One is the increase in birth rates which is continuing through these recent years. Along with that is the growth in longevity - four years added to the life expectancy of people in this country in the last decade. Granted that a large percentage of that increase is in some of the younger ages, there is an impact on the pattern of the people and the nature of their spending. There have been other trends -- trends toward rural living, population shifts towards the West and South, increased attention of customers to housing and to automobiles. Those are factors, it would seem to me, that you as business planners should watch very closely.

Sooner or later I suppose the consumer is going to say "Hold - Enough!" He is going to stop buying things. The extent to which that is true I'm not sure. Ever since the very earliest salesman tried to sell things to unwilling aborigines, I suppose he cursed their dammed wantlessness, and I suppose in like measure that may be true now. I'm reminded of a little story of a small boy who told his sister that she was eating too much. He said, "If you do, you are going to stretch your stomach." I wonder if the American customer hasn't stretched his stomach over these last years of high consumption. The theoretical economists have paid some attention to that and developed a notion that peak levels of consumption do have their impact on later periods. To the extent that is true, I think we will see consumer takings in the years ahead depart rather substantially from the pattern that we might have had some years back. Along with that, of course, you recognize the impact of a changed distribution of income among the different classes of the population.

I think it would be remiss if I didn't make some mention of the possible long-run implications of our high capacity of production. There may well come a time, and I should think we would willingly embrace it, when we as customers decide to accept leisure rather than economic goods -- leisure in the form of shorter working days, a shorter working week, longer vacations. Any such trend would increase demands for certain types of goods for the enjoyment of leisure, and alert planning will look in that direction.

I haven't said anything this morning about bank credit, or financing, or even anything about price levels. I haven't said very much about them because in part I am inclined to think these credit and financial aspects are somewhat over-emphasized. I do not mean to imply that the threat of inflation is past. As a matter of fact I

think it is still present, but I think we are more likely to find its threat, not in the area of financing, but rather in the area of voluntary (I probably should say involuntary) agreements over wages, with later impacts in the area of costs, and in the area of government supports of agricultural prices.

If what I have said this morning seemed to give an overly optimistic point of view, I can only say that in part I have tried to develop some of the more favorable aspects of the picture. The time is right for you to be cautious, but it seems to me that over-cautiousness is an excess that itself must be avoided if we are to look to you as business planners for a high level of continued activity. A very wise observer of business conditions once remarked to me that in his opinion most errors in business forecasting seemed to be made by expecting that a development would come sooner than it did come. Thus, a good operating rule might be: if you can see it coming, don't expect it quite so soon as it appears to be coming. I am quite willing to apply that rule to any suggested forecast of a recession for 1952.

SURVEY OF CAPITAL REQUIREMENTS OF AMERICAN INDUSTRY AND POST-ARMAMENT IMPLICATIONS

Dr. Dexter M. Keezer
Director, Department of Economics
McGraw-Hill Publishing Company, Inc.

I am inclined to think that one of the most debilitating of American ailments is making speeches. And I am not sure that listening to them might not also be included. Consequently, I normally require a considerable amount of coaxing when I'm asked to come and talk to a group. That's not true in this case. I literally leapt at the opportunity to talk with you. Also, I am anxious to make a very good impression. The reason is that almost all of you are either present or prospective collaborators in our studies of plans for capital investment; and these studies are important to you, to us, and to the nation. I appreciate the help that you've given us and I seek your further cooperation.

The program says my subject is a "Survey of Capital Requirements of American Industry and Post-Armament Implications." I translate that freely to mean the "Outlook for Capital Expenditures by American Industry." Now, as your Chairman has indicated, that is in a very real measure the outlook for general prosperity. For outside of war time, it is true that capital expenditures by industry and general prosperity have gone up and down together. Economists will probably argue until the last economist expires as to what's cause and what's effect. I don't know and I shan't argue it. As I see it they are Siamese twins, and I know no reason to believe that the cord is going to be broken soon.

To avoid any undue suspense concerning my feelings about the prospects of capital investments by American business, I shall say at the outset that I think they have been gravely hurt by the decision of the National Wage Stabilization Board in the Steel Case. But it is my impression that the prospects would remain relatively good under two conditions:

(1) If we can count on business taxation going down in good season, in fact, simultaneously with the fall-off in defense expenditures, and

(2) If salesmen of consumer goods move off of what in a good many instances have become their extremely well-upholstered fundaments and go to work in the manner for which they are noted.

Now, implicit in what I say is, of course, a basic assumption: That we are not on the eve of World War III. I know nothing about such matters. I am not a military expert. I believe if I were assigned to guard prisoners I could avoid being captured by them. Perhaps that has come to qualify one as a military expert, but I do not claim it. At any rate, my assumption is -- We don't have World War III upon us.

As I understand the present schedule, defense expenditures will begin to taper off at about the end of this year. Also, capital expenditures by industry are due to decline next year. The fear has been that industry has maintained capital expenditures at such a high level that there will not be much left to do in that line for a time and that consequently a very sharp drop will take place. Now the people who have that fear are not fools. A survey indicates that by the end of this year

the industrial capacity of the United States will be, if present plans are carried out, over twice as big as it was in 1939. So, to be worried that we have built abundantly, if not overbuilt factory equipment, is not foolish. We do, however, know that American business management wants to go ahead with very large capital expenditures in the years ahead. A survey we made early this year indicated that industry - defined to include manufacturing, mining, utilities, transportation and communications - plans to spend about 21 billion dollars for capital equipment. In dollar volume that is an all-time high by quite a margin and in physical terms as well, even allowing for the increase in prices. But quite a bit of that as you know -- we estimate 5 to 6 billion dollars -- is specially induced by provisions for accelerated depreciation and other government stimulations. So the question becomes -- what about next year when all, or at least some considerable part, of these special inducements are gone.

Before getting to that, however, some of you may say, what about this year? We've read reports of cancellations, very considerable cancellations; we've heard of, perhaps experienced, difficulty in getting funds. Are the plans for capital expenditures likely to be fulfilled or are there likely to be cancellations? We haven't made a detailed survey on that point, but we study it continuously, and it is our present understanding that the attrition and the falling by the wayside is no more than customary -- so that we do go through this year with a very high level of capital expenditure.

As compared with the 21 billion dollars expenditure this year, we have found that American industry already has planned to spend almost 17 billion dollars in 1953, 15.1 billion in 1954, and slightly over 14 billion in 1955. Now you may say that a drop from 21 billion to 14 billion is a whale of a drop. However, invariably, plans tend to grow as we approach the time of fulfillment. Things are overlooked. And that 1955 figure is larger already than the amount spent in any year, except one, prior to 1950. So, as far as the intentions and the wishes and the aims of American management are concerned we are set to carry out a level of capital expenditures which is consistent with a satisfactory level, or a higher level, of general business activity.

In asking about the plans for future years, we said, make two assumptions: (1) that industrial production will drop about 10% after 1952, and (2) that the Excess Profits Tax is repealed, but that the general 52% tax continues. This brings me to the first big _if_ in the outlook for capital expenditures -- _if_ we can count on defense expenditures and the rate of taxation on business income moving down from the peak hand in hand. There are two reasons, both crucial, why that must be. One is simply to have the money, profits being the principal source of funds for capital expenditures. The other is to have the incentive. In other words, if we are going to have a drop in industrial production, which means a greater proportionate drop in profits, we must have prompt relief in business taxation.

At this point the Wage Board decision in the Steel Case seems to me to come into play to darken the outlook for capital expansion by business. The effects of the decision will be to increase costs substantially in a very substantial segment of American industry. Steel, as you know, tends to set a wage pattern for a considerable segment of industry and we have unions backed up awaiting the outcome to say, "Fit us into the pattern." Now, the increase comes at a time when there is very little prospect of being able to float it off successfully by an increase in prices. As I read the record and study it, the problem by the end of this year for many industries seems not to be how they can pierce their price ceilings -- if in fact the

price ceilings still prevail -- but how on earth they can hang on to them. Supplies are coming in with the speed and the force which makes, it seems to me, the discussion of price ceilings in a good many of these areas largely academic. The squeeze on profits of major segments of American industry will squeeze the capacity to carry out plans for capital expenditures. Now that argues with even greater force that we must have tax relief promptly. Certainly the Excess Profits Tax should go by next New Year's Day and the general tax rate should be reduced shortly thereafter, if we are not going to have a serious stripping of funds.

I have mentioned incentive. Theoretically, in our scheme of things, profit is also the incentive for capital investment. I confess I'm bemused by this whole issue of incentive. I take it, judging from your general appearances of prosperity and good health, you belong in the middle and upper ranges of business executives. As I read the record you have been progressively taking a beating in your take-home pay. What have you done? You keep on working a little harder than ever. The moral would seem to be that if you were taxed down to the point of virtual starvation, you'd be working to a degree that would be fantastic. So I pass up the question of incentive as far as individuals are concerned. Nevertheless, we've created a situation where we are putting a tight squeeze on the capacity -- I would say also the inclination -- to carry out capital investments. Crucial to this area, and I believe crucial to general prosperity because the two things go together, is reduction of business taxation. I have no illusion that it is going to be easy to do. I know of only one tax that has more political glamour than a tax on business profits, and that's a tax on something they call excess profits. So, all of you in the role of business leadership have a job of education to do which I regard as extremely difficult.

We have encountered many cases where capital expenditure can be made, where there can be a great saving at almost any level of sales, and the management said: "Well, we guess we'll wait until the general situation looks better." I've conjured up my own feeling about what the ultimate in this line is. I expect to encounter a recorder of bankruptcies who is doing such a terrific job that he finds he needs labor saving equipment, but I expect that recorder of bankruptcies to tell me that he doesn't plan to buy the equipment until business in general picks up.

Dr. Bliss mentioned the impact of research on capital expenditures. I submit that it's much more potential than actual at the present time, but you've got to have a thriving pattern of sales. It seems to be one of the conditions.

That takes me to my second major _if_ -- If the salesmen (and I take it Forrest Walker is going to talk about this at length) get busy and live up to their reputation. It looks to me as though we have become so well heeled as a body of consumers that we can take or leave about 40% of everything that is produced without any immediate personal inconvenience. We had a dramatic illustration of what this means last year, between the first and fourth quarters. Disposable income -- that is the money in the hands of consumers after taxes -- increased about 11 billion dollars. Everybody said, "Oh! Oh! More inflation." There wasn't more inflation. Savings, and I assume the figures are not over 50% wrong, went up 13 billion dollars in that same period, and so we had dragging markets. People were having trouble selling television sets. I can't regard that as a cultural disaster, but it had its economic impact. Even during this period of rushing to rearm, we have a situation where the consumer is free to "take it or leave it", so far as a large share of our production is concerned. In the last analysis this makes the salesman a key custodian of our general prosperity and the outlook for capital investment. As you know, economists

and salesmen as a whole get along extremely ill. Economists tend to think of the salesman as a backslapping, hollow kind of fellow. Salesmen on the whole think of the economist as a rather disagreeable, introvert type using large terms signifying very little. Personally, however I've reorganized my behavior so that now every time I see a vigorous salesman I tip my hat, and I think that some of the rest of us better start doing that.

Our surveys and studies indicate that there will definitely be a shift toward modernization of equipment. In this connection I'm simply satisfying myself with the statement that a very large part of American industrial equipment belongs in an antique shop and has no place in a modern factory. Roughly I'll guess that we can increase the output of American industry 20 to 25% without any increase in labor, while making jobs easier. We'll simply modernize our equipment. So, we are not digging ourselves a grave of increased capacity by carrying on a high level of capital expenditures.

Now, to round out a discussion of capital investment I should say something about the outlook for investments in the foreign field. I don't because frankly I don't suspect myself of having anything to say that is worthwhile. I'm impressed by the fact that the volume of capital investment abroad is imposingly large -- about a billion and a half per year in recent years. I do have a feeling that it is unfortunate that we seem to rely so heavily on government in this field. I'd feel happier about the outlook for capital expenditures abroad if we seemed to have more faith in our own scheme of business.

I want to emphasize again that the decision of the Wage Board (You may remark it isn't in effect, but most of it will be) is a grave blow to the outlook for capital expenditures in the United States by constituting a severe squeeze on profits. But even so I think we can overcome that if we can get relief from the burden of business taxation in good season, and if people who sell to consumers really live up to their reputation.

I would submit that the greatest mistakes made by business forecasters have been due to not knowing what is going on politically. That is an area that I shan't go into. I've tried to limit myself to my subject: Capital Expenditures and an Economic Analysis. In this crucial part of our prosperity -- our well being -- you play a key part as budgeting officers. I hope I've said something that will be useful to you professionally and useful to our country in carrying on this major phase of our economy.

POST-ARMAMENT MARKETING

Q. Forrest Walker
Economist
R. H. Macy & Co.

Expenditures to Expand Capacity

Perhaps we can get a little better grasp of the importance of the marketing problem if we consider briefly the size and speed of recent increases in outlays for new plant and equipment. During the past six years, we have expended about $130 billions for new production facilities, of which nearly two-thirds is estimated to represent new equipment.[1]

About 60 percent of the $54 billions of new capital expenditures in this period by manufacturing and mining corporations was accounted for by the non-durable goods industries.[2]

The Department of Commerce has roughly calculated that in constant 1945 dollars the gross capital assets of manufacturing corporations in that year amounted to $62 billions and the addition in the 1946-51 period to $35 billions.[3] "If both figures are adjusted for gross retirements since 1945," says this study, "it appears that approximately two-fifths of the current gross stock of fixed capital is less than six years old."[4]

Estimated Gain in Capacity

These adjusted dollar estimates of changes in fixed capital probably understate the actual increase in capacity because the new expenditures represent greatly improved equipment and plant layouts. Although our measurements leave much to be desired, it is a fair guess that in the 1945-52 period, we will have added at least 50 percent to our manufacturing capacity.[5]

We must remember, too, that only about 40 percent of the 1946-51 expenditures for new plant and equipment were for the manufacturing and mining divisions of the economy. To this great postwar expansion, we have now added a defense program. If the planned goals are attained, there will be further large additions to existing capacity in certain defense and defense-supporting industries.

Post-Defense Fears

"If at the end of the rearmament program," says the Conference Board, "there has accumulated little if any shortage of consumers' goods--as many are now beginning to believe may be the case--the question of what shall be done with the men, the machines and the materials that have been going into rearmament (which will,

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(1) Capital Goods Review, Feb. 1952, Machinery and Allied Products Institute, Chicago, Ill.
(2) Ibid.
(3) Lawrence Bridge, "Capital Expenditures by Manufacturing Industries in the Postwar Period," Survey of Current Business, Dec. 1951, p.17.
(4) Ibid.
(5) Cf. Capital Goods Review, op. cit.

theoretically at least, not be needed in the same amounts thereafter) is now beginning to trouble many minds. Obviously, only an economy on a scale much larger than any we have enjoyed over any extended period in the past is implied in any forecast of stability and high level employment in the post rearmament years."[6]

Over-Expansion Before Korea

Even prior to the defense program, there were reasons for apprehension about the high rate of investment in new production facilities. Over-expansion is peculiarly characteristic of great postwar booms. This one lasted a long time. Under the stimulus of huge replacement demands and rising prices, future markets can easily be over-estimated. Management can measure what new plants, machines and methods are capable of producing, but it cannot with equal certainty determine what quantities can be marketed over a considerable period at satisfactory prices. Break-even points were much higher than in more normal periods. Profitability became more and more dependent upon continued high capacity operations. There were signs of impending over-production.

Defense Strains and Uncertainties

The outbreak of Korean hostilities, however, gave a waning replacement boom a new lease on life. What has happened since that time needs no repetition here. We all recognize that the defense program has created new uncertainties. It has placed great strains upon our resources. Taxes have been pushed far beyond healthy economic limits. Costs are high, and still rising. In the civilian sector of the economy, there has been substantial contraction of output. Margins of profit have been shrinking and in many cases they have disappeared. The high rate of activity in defense and defense-supporting industries has obscured the severity of the readjustment in other lines. Moreover, defense spending may be re-phased at any time as internal and external conditions may require. The possibility of serious mistakes of business judgment has been greatly increased.

Defense Program as Business Support

One of the more disturbing features of the defense program is the extent to which it is regarded as a substitute for intensified private effort to maintain a high level of business activity. Nearly all business reviews consider it a major prop against a possible recession. When unemployment appears in civilian sectors of the economy, forced diversion of defense contracts at higher purchase costs is often openly advocated. Figures of startling magnitude for future maintenance costs are freely quoted. It is said that these high maintenance costs will cushion readjustments after we "get over the hump" of the defense program. We have been publicly warned against the danger of letting rearmament become a new "vested interest."

Spreading the Defense Burden

No one doubts that over the longer period we will find use for all our new capacity and also add to it. That is characteristic of our dynamic American economy. But the longer term growth of the country does not meet our current problem. Under partial mobilization there are limits to the defense burden we can carry and still maintain a healthy economy.

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(6) The Conference Board, Growth Patterns in Industry, Studies in Business Economics No. 32, Feb. 1952, p. 15.

Unfortunately, there is no simple mathematical formula for the determination of these limits. It is said that at its peak the defense program will not represent more than about 18 percent of our gross national product. No one really knows whether this is a safe or even a reasonable diversion of productive effort. We do know, however, that if the non-defense part of the gross national product can be moderately increased, it will be much less difficult to provide for adequate rearmament over a longer period without serious economic strain.

Bigger Markets Needed Now

We cannot safely postpone efforts to increase non-defense output until we "get over the hump." It is true that defense requirements impose some limitations, but there are large areas where they are not a barrier to reasonable expansion. In a sense, the subject for this discussion is a misnomer: we must find ways now to broaden our markets. If public and private policies can be directed toward this objective, we will certainly face less serious troubles when we return to more normal defense spending. Obviously, better marketing is only one part of the effort to accomplish this result, but it is a verv important part.

Some Readjustment Already Past

We must face too the possibility that these intensified marketing efforts may be made more difficult by the impact of necessary postwar readjustments. We have never yet escaped more or less serious economic readjustments after great postwar booms. However, the sharp reductions in output of many consumer goods during the past year suggests that some part of this sort of readjustment is now behind us. We cannot say with any assurance that we will not experience further set-backs before a satisfactory economic balance is restored, but there is a probability that it may be less severe than in previous postwar periods.

Need for New Economic Statesmanship

We can cushion the impact of these adjustments if we can achieve a new national unity of purpose to spur sound economic growth.

That requires removal of many of the economic shackles which have been imposed in the names of "welfare" and "social equity."

It will necessitate a new understanding of the danger in progressive impairment of incentives. Otherwise, we shall prevent and impede intelligent venturing in new products and markets which a greatly improved technology is constantly making available to us. It is not too difficult to impair the productiveness of our system and to dissipate the wealth it has created; but only a high order of statesmanship can reverse the subtle political processes which bring about these adverse developments.

Major Marketing Problems

It is instructive to review the opinions of fifty-six top marketing authorities as reported in the most recent proceedings of the Annual Boston Conference on Distribution.[7] This group was asked to state the major problems to be met in achieving

(7) Proceedings of the Twenty-Third Annual Boston Conference on Distribution, Retail Trade Board & Boston Chamber of Commerce, 1951, pp. 84-112.

more effective and efficient marketing over the next five or more years and the kinds of action needed to meet them. Four of the ten major problems were directly related to government.[8] These included (a) government restrictions limiting production and the efficiency of our marketing system, (b) misguided tax policies, (c) the growing weight of big government on the economy, and (d) inflation.

The latter overshadows the others. It is summed up in this way:

> "Inflationary trend due to (a) excessive government spending for goods in competition with the civilian economy; (b) increasing the money supply far beyond the actual output of the economy; (c) government deficit spending over many years; (d) enormous extension of credit for speculative purposes; (e) farm parity price system; (f) wage increases without increases in productivity, resulting in higher prices. This represents a creeping tendency to price larger and larger numbers out of the market."[9]

This group also placed stress on the enlarged productive capacity of our industries, the lack of adequate facts on market potentials for products and on consumer motivation, inadequate public understanding of the functions of distribution, poor organization of staff planning, wasteful handling in the physical distribution of goods, decentralization of shopping areas, and the effects of supermarkets on other forms of distribution.

Expert Marketing Opinions

As one might expect, the predominant note in most of the suggestions for action to meet these problems was more and better market research.

Such research was deemed necessary to study products "in terms of quality, price, performance, and design," to analyze markets intensively, to investigate consumer motivation more thoroughly, and to obtain better measures of the effectiveness of advertising.

Other suggestions which received frequent mention were:

(a) Improved selection and training of sales organizations;
(b) Analysis of distribution costs to aid in their reduction and better pricing;
(c) Education of distributors and retailers in selling and merchandising;
(d) Modification or removal of government regulations and legal restraints on efficient distribution;
(e) Broader application of the self-service principle; and
(f) Better education of the consumer.

Less frequent mention was made of increased mechanization, decentralized selling, organizational flexibility and more effective "point of sale" selling. Naturally, in a symposium of this type, with its space limitations, the various contributors emphasized the subjects then uppermost in their minds. There was considerable uniformity of opinion, but that too was not unexpected because most of these suggestions are subjects of perennial discussion in marketing circles.

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(8) Ibid., p. 84.
(9) Ibid., p. 84.

Reappraisal of Marketing Budgets

The mere listing of these opinions suggests that under present and prospective business conditions, there should be most careful reappraisal of marketing budgets, particularly the appropriations for research and sales training.

Many companies which have not hitherto found it necessary to have marketing research divisions will find that the coming competition will require them, or that they must seek the help of outside agencies.

Still others may determine that present appropriations are large enough, but that effort should be directed along more productive lines.

Since the marketing problem often begins on the drafting board, diversion of part of the marketing expenditure to intensified study of the product itself may prove particularly profitable.

Population Changes and Marketing

World War II and the postwar boom have brought many economic and social changes of special marketing significance. Population has not only increased substantially, but age group patterns over the next several years will modify profoundly the direction of selling efforts. There have been many important geographical shifts in population, not only from the cities to the suburbs, but from the eastern and northeastern parts of the country to the south, the southwest and the Pacific areas.

Economic Changes and Marketing

We have had spectacular changes in the distribution of income which some competent scholars describe as a "bloodless social revolution."

Due to the ravages of inflation and high taxes, millions of consumers with more or less static incomes have been priced out of customary markets. A somewhat smaller group has enjoyed higher incomes than ever before, both in absolute amount and in terms of real income. These millions have spent their newly-found income for richer diets, new homes, better clothes, more expensive automobiles and a wide variety of goods and services that they could not formerly afford. Agricultural areas have enjoyed a long, sustained period of high income. Great riches have flowed into areas which hitherto suffered continued economic blight. With these changes in income distribution, there have been profound changes in public taste and preferences.

Need for More Marketing Research

These are some of the reasons why the marketing experts are so insistent that our research techniques and tools be used now to ascertain the facts about the effects of these economic and social changes. Many of our former concepts of markets have become obsolete; and many old formulas which were successful in the boom years will not work well in the highly competitive years which lie ahead. During the long period of business expansion, we have built up certain traditions and habits in decision-making which now require thorough re-examination. Management must now exercise every precaution to avoid the mistakes which arise from too great dependence upon boom experience. New and better marketing research cannot fail to aid materially in improved decision-making at high policy levels.[10]

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(10) Marion Harper, Jr., "Making Business Decisions," Journal of Marketing, Vol. XV, No. 1, July 1950, p. 57 ff.

Control of Advertising Budget

The advertising budget is likely to be particularly troublesome to the budget maker. It becomes an acute problem when there are actual or impending declines in sales volume. When sales and profits are rising, these expenditures may have been increased on the theory that the time to get additional business and build public acceptance for a product is when business is very good, or on the theory that extra large expenditures are not too costly when tax deductibility is considered, or perhaps on a combination of the two theories. When sales resistance is growing and profits before taxes are less satisfactory, it may be forcefully argued that added expenditures are justified to avoid adverse operating results and to protect the prestige already gained.

Lack of Good Measures of Advertising Productivity

It is often hard to reconcile these conflicts satisfactorily. Perhaps the prime reason is that we are not yet able to measure precisely the effectiveness of the advertising expenditures. What we do know is that there is a maximum that we cannot reasonably afford and that there is likewise a minimum below which we may not safely go. Neither can be exactly defined, but between these uncertain limits we have to find what we think is a reasonable compromise figure for the budget amount.

Sophisticated Judgment vs. Statistics

When we try to measure the effectiveness of the advertising dollar, we are always confronted with many variables for which we are seldom able to make proper allowance.

In a recent study of this question of keeping advertising expenditures within reasonable bounds, it has been aptly said that statistical research may provide "an important benchmark for approaching this problem, but econometric estimates must be supplemented by sophisticated judgement of the nature of the product."[11] If advertising expenditure merely diverts consumer purchases from one brand to another, it may serve the individual company well but fail in the larger purpose of broadening the entire market for a given type of product. We need the kind of advertising that makes more people want more things, and at the same time produces results for the individual advertiser.

Cyclical Advertising Adjustments

The study to which we referred contains these interesting conclusions:

> "Product characteristics that favor extreme cyclical fluctuations are: large shifts in the marginal efficiency of advertising; high income elasticity of demand; sharp constriction of margin over production cost and intensified competition in depression; a low proportion of investment type advertising and a short response lag; and the lack of strong growth in the potential market. Converse conditions favor stability in the advertising appropriation."[12]

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(11) Joel Dean, "Cyclical Policy on the Advertising Appropriation," Journal of Marketing, Vol. XV, No. 3, Jan. 1951, p. 273.
(12) Ibid.

Lower Consumer Prices to Employ Added Capacity

Barring greater diversion of our resources to military purposes than now contemplated, it seems clear that we will not find markets for all the civilian goods we are capable of producing unless prices to the consumer are lowered.

At the peaks of past postwar booms, business men have generally expressed little hope of reducing costs and prices. When customers became unable or unwilling to pay the current prices, inventories piled up and production declined. The process continued until a new cost-price equilibrium was established. This new equilibrium was found by eliminating the wastes and extravagances which accumulated during the boom and by devising cheaper and better methods of production and distribution. That is usually a painful and disturbing process, but so far we have always found a way out. Only those with little faith in our system can believe that we will not again find it.

Human Factor in Distribution Costs

We have by no means exhausted the possibilities of reducing manufacturing costs, but there are greater difficulties in achieving lower distribution costs. These difficulties stem from the elemental fact that the ultimate decision to buy or not to buy the final product rests with individuals, and there is no way of mechanizing the consumer. This does not mean that reduction of distribution costs is a hopeless task, but merely that the subject must be studied more intensively. That is why many contributors to the Boston symposium emphasized more scientific study of consumer motivation and more searching inquiry into distribution costs.[13]

Know Your Distribution Costs

To a group of budget-makers, it is unnecessary to do much more than to mention the importance of knowing more about the details of distribution costs.

In the individual company, we cannot do very much about these costs until we know what they are. They involve elements of fixed, variable and joint costs, and allocation of these elements is often more of an arbitrary judgment than any precise determination. Probably, we will also discover new opportunities to save money if we can find better ways for reducing time wastes. If we can reduce the time interval from cash to cash, we can lower interest, warehousing and many other marketing costs. We can also cut many marketing wastes by attacking them at the point of origin. Poor styling and design may create a chain of increased marketing costs.

High Costs of Freedom of Choice

Critics of high marketing costs are prone to place the responsibility upon the national advertiser, intermediate, and retail distributors. The service that the public demands, the complexities of our economic processes and costs of freedom of consumer choice are seldom properly appraised by these critics or well understood by the consuming public.

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(13) Cf. Q. Forrest Walker, "The Nature of the Distribution Cost Problem," *Journal of Marketing*, Vol. XI, No. 2, Oct. 1946, pp. 151-158. Much of the subsequent comment on this subject is drawn from the above article.

Real Distribution Cost Issue

Much has been said about the relative proportions of the final price represented by production and by distribution costs. As manufacturing and distribution become more minutely subdivided, we may expect that the distribution proportion of the final price will increase. What really counts is not the percentage division of these costs, but the extent to which the market is broadened by lower absolute prices for the goods we produce. We can also do more than we are now doing to educate our distributors and the consuming public about the nature of these costs.

Necessity for Price Competition Among Distributors

Some brief comment should here be made about the hampering effects of ill-considered public restraints upon efforts to secure bigger markets.

The controversy that now rages over resale price fixing is one illustration. Long ago it was said that an iron-clad retail price can never capture more than a fraction of the consumer market. If we believe in the benign effects of competition among producers, we cannot logically deny its merits in the distribution of goods. We cannot develop great consumer markets by erecting barriers to competition among distributors and reserving the right to compete to producers.

Cost Standard in Robinson-Patman Act

Still another illustration is the Robinson-Patman Act with its restraints upon price differentials.

Few quarrel with the broad principle of prohibiting unjust and unreasonable price differentials, but it is unfortunately true that the cost accounting required to conform to the statutory standard is so expensive that it is prohibitive to many companies, and forbids many justifiable price differentials. If this rigid cost standard were abandoned in favor of the test of reasonableness, many consumer-goods prices could be reduced without real injury to the small dealers whom the statute is intended to protect. The long, slow and costly judicial determination of when a price reduction is made in good faith to meet competition is still another obstacle to full competitive pressure to keep prices down. But these are complicated economic and legal questions which cannot be explored here.

Summary

By way of summary, it may be said that the rapid expansion of producing capacity during the postwar boom and the defense spending period has created a major marketing problem.

Dependence upon defense spending to sustain a waning civilian boom is a dangerous substitute for intensified immediate action to broaden the markets for civilian goods.

We need government policies that encourage intelligent risk-taking to promote sound economic growth.

We cannot afford to wait until we "get over the hump" to improve our marketing.

Better marketing research, more productive advertising, intensified selling,

careful analysis of distribution costs and action to reduce them, removal or modification of many legislative restraints on marketing, lower costs and prices, education of dealers and consumers--these are some of the points of attack on the marketing problem.

With faith, imagination, ingenuity and good operating flexibility we can meet this challenge of our times.

THE ECONOMIC OUTLOOK

GENERAL DISCUSSION AND RESUME

Questions from the floor brought out the following points:

(1) Although it is desirable to plan expenditures far ahead, constant review and revision is necessary to maintain valid estimates.

(2) Dr. Keezer reiterated that much of the present production equipment is fit only for an antique show, but the squeeze on profits may well cause a decline in capital expenditures.

(3) Dr. Bliss suggested that the speed-up in tax payments, requiring larger payments in the first half of the year, may have a further depressing effect on capital expenditures, and Dr. Keezer mentioned the reverse effect of rapidly rising depreciation.

(4) Dr. Keezer agreed that, although plans for capital expenditures in future years normally tend to grow as time passes, a deterioration in business may cause a change in the opposite direction.

(5) Mr. Walker reiterated that in recent years there have been many economic and social changes. A large segment of the population has found the going pretty rough. But a smaller group has enjoyed higher incomes than ever before, both in absolute amounts and in terms of real income. These people have spent their newly increased income for richer diets, new homes, better clothes, more expensive automobiles, and a wide variety of goods and services they could not formerly afford. Agricultural areas have enjoyed a long sustained period of high income and great riches have flowed into areas which hitherto suffered continuous economic blight. With these changes in income distribution there have also been profound changes in public taste and public preferences for product. That is why the marketing experts are so insistent that our research techniques and tools be used now - not after we get over the hump - to ascertain the effects of these changes.

(6) Dr. Bliss said there are times when cash needs become very strong indeed. Characteristically this occurs in expansion periods rather than in contraction periods, and when prices are rising rather than when they are falling. At present, also, the movement toward earlier collection of corporate taxes is reducing working capital. In such times it is natural that credit should be used. In fact that is one reason why we have banks: to provide exactly the working capital that companies need.

(7) Dr. Keezer added that the shortage of working capital is a problem which seems to have hit smaller companies the hardest.

(8) It was agreed that the reluctance of many companies to borrow from banks is probably due more to the psychological effect than anything else.

(9) In response to a question about his statement that as consumers we can take or leave about 40% of everything that is produced, Dr. Keezer said his figure was very rough and could not be applied to any one product line.

(10) Mr. Walker does not anticipate a widespread boom in sales as a result of the removal of credit restrictions, largely because consumers became well stocked in the buying flurry of a year ago.

Dr. Bliss' comments at the conclusion of the session on the business outlook are presented below.

"We have all agreed that the present situation is one which has been strongly influenced and buttressed by high government expenditures. I think all three of us (speakers) are concerned with the fact that government expenditure itself is not the long run answer for an economy that prides itself on having free enterprise. The shifts that have taken place in government actions are, I think, unbalanced. These actions are not necessarily the things that in the long run are going to be needed. As Mr. Walker quite properly stressed from the point of view of distribution, the study of distribution costs and research have a lot indeed to do with our own planning. Mr. Keezer's comments in respect to capital formation, I think are pretty much to the point and he has spoken so eloquently to you of his position that it certainly needs no comments of mine.

"I have thought of our being not so much at the hump (as many feel), but rather on a plateau which will continue for a reasonably long period of time. I don't think anyone in this country can help but hope that defense expenditures will, in the years ahead, dwindle off. I find it extremely anomalous that this country has to find prosperity in defense expenditures. And I believe that we as a group will have to learn to get along on the normal operation of peaceful years rather than to look to what someone has called the economic equivalent of war.

"The problem of assessing what we have said is yours, because you are talking about specific industries and we have been talking about things in general. I can't help thinking that maybe in these circumstances you are a little bit like the darky who was seen walking slowly down the dusty road, half asleep and dragging a rope. Someone came up to him and said 'Mose, what you got there?' He looked around bewildered and said, 'I don't know. Does it mean I've found a rope or lost a mule?' It is up to you to decide whether what we have been telling you this morning is that there have been found ropes, or lost mules.

"One final word. I like to remember the Chinese character for crisis. You know how the Chinese build up their written language, by combining characters. Well, it so happens that the Chinese character for the word crisis is made up of two separate characters. One of those characters spells out the word danger, the other spells out the word opportunity. And I submit that no better challenge could come to business men or to business planners than just exactly that -- danger and opportunity. I think that holds regardless of the period of time in which you work."

2 MANAGEMENT OF BUDGETING AND FINANCIAL PLANNING

CHAIRMAN'S OPENING REMARKS

Walter R. Bunge
Allis-Chalmers Manufacturing Co.

This morning I was very happy to see so much enthusiasm in the crowd, so many questions afterward. I am sure that the subject this afternoon will be no less controversial. I would suggest that you jot down a question here or there as we go along because afterwards we shall again have a question period, which we hope will bring out many new ideas.

A budget is simply an approved set of plans of all phases of the company and of all levels of management, within the various phases, put down on paper where you can get a good look at it. Now that's probably the over-simplification of the day because budgeting includes, of course, coordination, cooperation, balancing, follow-up and a great many other things. You all appreciate that. It's a form of analytical management. Dealing as it does with income and expenses, with facilities present and future, and with plans and relationships, it is very, very broad. It covers every phase, every part of the business. It is all inclusive.

This afternoon we are going to hear about the basic principles which govern the establishment of budgets, the administration of the budget program, and the broader aspects of financial planning.

One of the speakers who was scheduled to appear is ill, but we do have a very able substitute for him -- a man on his staff who will give you his talk. But first of all we are going to hear about market objectives, as most of our plans evolve about at least an estimate of volume and volume is brought about by sales. The discussion of market objectives, sales plans and the budget will be given us by Mr. John R. Sargent who is a partner of Cresap, McCormick & Paget.

MARKET OBJECTIVES, SALES PLANS AND THE BUDGET

John R. Sargent
Partner
Cresap, McCormick and Paget

Running a business would be dull indeed if all its aspects could be reduced to formulas. Doubtless that's why socialism and communism are so repugnant to most Americans - they attempt to regiment all activities and reduce them to masterminded formulas. Business thrives in this country - at least a large segment of it thrives- because there is maximum opportunity for non-regimented thinking; for real initiative and ingenuity. We have all seen examples of businesses that grew rapidly and successfully by the mere fact that they did not follow the traditional or standard pattern of their competitors.

I am starting on my subject "Market Objectives, Sales Plans and the Budget" in this way because at the outset I am extremely anxious to emphasize the importance of the human element in establishing market objectives, sales plans and sales forecasts. Of course good formulas and good procedures can play a significant part - a very significant part - but our rather intimate management engineering acquaintance with a wide variety of different types of businesses has convinced us that for any company, large or small, there is no substitute for imaginative thinking and planning on the part of company executives. We have yet to see two companies, even ones in the same industry, where exactly the same procedures will apply in establishing market objectives and sales plans. There are bound to be variables injected into the picture due to type of ownership, organization and personnel, methods of selling, financial abilities, methods of manufacturing, and various other factors.

Definitions

While I don't want to stray far into the field of semantics, I think it is important first that we define and examine the three terms Market Objectives, Sales Plans and Sales Forecasts, for there are many interpretations of each. It is fairly common procedure today to refer to all three as Sales Forecasting, but I believe it provides a better and clearer understanding of the concepts and activities involved to label each separately.

Market Objectives

The words market objectives refer to the company aims marketwise - that is the position in the market it is striving to attain. Usually the long-range market objectives are well beyond the sales forecast for the current year, although this is not necessarily always the case.

Every business should have long-term market objectives which are closely attuned to the over-all company objectives. Unfortunately, too often the stated market objective of a company is merely to sell all that it can. While this may be laudable, there is some doubt whether it can be classed as a true market objective or not, for the basic purpose of having an objective is to establish a feasible and finite goal for accomplishment.

In any case, the company's market objective should not just encompass sales volume alone. A market objective should take into account long-term market stability,

distribution costs, competitive conditions, and depending upon the industries involved, frequently a variety of other factors.

The importance of considering long-term market stability in establishing the market objective does not need very much expansion. Many markets, especially industrial ones, vary widely in size according to economic conditions. The company which attempts to gear its market objectives to the maximum market may find itself in a sad predicament in the negative cycle swings. Obviously, careful judgment is called for in setting the market objectives at a realistic, sensible level and in aiming the company's selling activities so as to gain a strong position in the more stable segments of the market.

It is also clear why consideration of distribution costs and competitive conditions can play an important part in setting market objectives. One of the problems of the "sell all you can" market objective lies in the fact that this may not be in the company's best interests. For example, in some fields, especially the highly competitive ones, it is not economic or judicious to attempt to garner more than a certain percentage of the over-all business for one company. Attaining sales volume beyond such a percentage leads to high sales costs and possibly to cut-throat competitive conditions.

Sales Plans

Coming to our next definition, the words sales plans refer to the means for attempting to reach the stated market objectives. The short-term sales plan is directed at achieving that share of the market objective that appears feasible during the current year, while the longer-term sales plans are aimed at the over-all, long-range market objective.

Attempting to describe good sales planning, is like trying to describe the elements of efficient sales management in a few, well chosen words. However, a little later on I intend to describe specific sales planning strengths and weaknesses to look for under varying types of sales management, and at this stage, let us say that sales planning should take into account and coordinate all activities affecting selling, including the following:

1. Over-all market and competitive conditions
2. Productive capacity, product costs and selling prices
3. Sales manpower, its quality, territorial allocation and direct sales expenses thereof
4. Distribution organization, its quality, location, and the cost thereof
5. Advertising and sales promotion, and the cost thereof
6. Sales direction, its quality, and the costs thereof.

If I should be asked to pick a single area in the average business today where strengthening and greater management attention would pay off, I would say that it would be sales planning.

Sales Forecast

The term sales forecast refers to the realistic assessing and combining of market objectives and sales plans into a feasible sales expectancy for the company that can serve as the basis for the annual budget. I feel quite strongly that, as a general sequence, the sales forecast should follow considerations of market objectives

and sales plans, although many aspects of sales planning and sales forecasting can be carried on concurrently.

I realize that I am opening myself to some considerable arguments on the basis of this arrangement; many people will probably say "How can you do your sales planning before the forecasts are made?" I believe this thinking results from a confusion between the meaning of the terms market objectives and sales forecasts. As an illustration let's say that our company sells a product in a market that amounts to ten million dollars annually and in 1951 our sales were $1,500,000, or 15 per cent of the total. It is our carefully determined objective that by 1954 we want to reach approximately 30 per cent of the market (or approximately $3,000,000 if the market does not change in size). If we could take the increases in even steps of $500,000 additional volume each year, that would mean a sales volume of $2,000,000 in 1952. However, in the sales planning process we determine that product redesign will be necessary in the spring of 1952, that our distributor organization in the Middle West needs strengthening, and we are going to have to train some new men, retrain some of the older ones, and hire a few replacements. Taking these factors into account, along with our other planning and forecasting procedures, our realistic 1952 sales expectancy or sales forecast is only $1,800,000 (even though ideally we would like to make sales volume of $2,000,000 in 1952).

When you get right down to it, how can we conceivably forecast sales for a company before we consider all the sales devices and means that can be brought to bear to influence the level of sales volume? Many a firm has managed to achieve increased sales in the face of declining markets through clever sales strategy - yet how could that sales increase be predicted without first conceiving of the plans to be applied? Probably one of the reasons that the forecasting record of many companies is so bad is that the forecasting job is not preceded by the establishment of long-term market objectives and by thoughtful and realistic sales programming for the period ahead.

Reviewing the processes that are used by many companies today in so-called "forecasting" activities will also serve to illustrate why some of the sales planning activities should be carried on in advance of forecasting and the two activities should be carefully coordinated. Here are seven commonly used methods (applied singly or in combination) for setting the annual forecast:

1. Basing it on last year's sales, or those of several past years.
2. Basing it on achieving some percentage of company productive capacity.
3. Basing it on an economic forecast.
4. Basing it on one or more market surveys.
5. Basing it on estimates of the headquarters sales staff or other company executives.
6. Basing it on estimates of district or division managers.
7. Basing it on estimates of individual salesmen, combined to form a total.

Now I don't want to appear to infer that these activities are worthless, for each can contribute to and play a part in the over-all planning-forecasting job. I do feel, however, that too often a sales forecast is developed by juggling the figures from one or more of these seven sources and then submitted verbatim for use in the company budgets, when that forecast has not been preceded by consideration of the company's market objectives, and a careful job of sales planning.

I know one company where the chief executive, a former production man, calcu-

lates his annual productive capacity and turns this over to the budget executive as the sales forecast on the naive theory that its's up to the sales department to sell everything the company can produce. It is an ideally simple forecasting system if it would only work. Unfortunately, not one of the key men in that company's management has a clear idea of the basic company objectives, the sales planning is done in a hectic and frustrated manner, and the company's performance in terms of realistic budgeting has been miserable. I have seen other cases where the sales forecast was entirely based upon the historic sales volume or upon a collection of the territorial sales estimates of individual salesmen with equally poor results. Too many companies do an opportunistic job of year-to-year sales forecasting without developing perspective on the longer term.

The Budgeting Executive's Role

Now if we agree that these three factors, market objectives, sales plans and sales forecasting, are all important in arriving at good basic data for the company budget, should the budgeting executive merely accept the end product, the sales forecast,or should he play a more active role in thoroughly reviewing the processes and and thinking involved?

From the standpoint of strict logic, since a reliable sales forecast is basic to a good budget, it only makes sense that the budget executive should have the opportunity to examine rather intimately all steps in the process that led to the forecast. Now I know that this may sound a bit idealistic, and that in many companies, the sales department will not welcome a critical analysis of this sort. With this in mind, I have tried to make the following suggestions as realistic as possible.

The budgeting executive's line of review and analysis will be dependent mainly upon the human element he has to deal with - and of course, in most companies the leading human element in setting up market objectives, sales plans and the sales forecast is the chief sales executive or the sales manager. Let's be frank and say that you will probably have to deal with one of three types of sales managers. These types are:

1. The extrovert, get-out-and-get-things-done type of sales manager, who is weak on the planning and analytical phases of his job.
2. The inside, introvert, paper shuffling type of sales manager who may be a planner, but tends to be cautious and unduly conservative, and is not prone to take aggressive action.
3. The balanced or ambivert sales manager, who combines both the abilities of the doer and those of the planner.

First is the popular concept of the typical sales manager as an aggressive, extrovert fellow, who works hard, lives hard, and continues to be optimistic even when things are obviously going against him. He's a doer rather than a planner, and there's nothing he likes better than getting out in the field with his boys and maintaining all the customer contacts he had when he was a salesman. Well, there's a fair amount of truth in this picture; if we look around at most of the sales managers we know, we would place maybe 50 per cent in this category. And this isn't necessarily bad, if we recognize his shortcomings and back him up with some staff planning and analytical assistance. After all, selling is not an exercise in military strategy which can be directed from afar by merely pushing buttons. A lot of hard grubbing, and driving, inspiring leadership is required.

Then there's his counterpart - the chairbound type who may have been promoted

from a staff assignment without field seasoning, who may be the President's son-in-law, or who may have just slowed down after receiving management responsibilities. In any event, and for whatever reasons, he is conservative, detailed in his planning, and inclined not to stick his neck out. He doesn't get out on the road much, and having no intimate feel of customers, competitors and market dynamics, he tends to concentrate on analyzing internal data, past history, and possibly his memories of things as they used to be. Again, this may be a somewhat extreme picture, but we can recognize about 30 per cent of our sales manager friends in this group.

Subtracting the 50 per cent extroverts and 30 per cent introverts from 100 per cent leaves only 20 per cent to be accounted for between the two extremes. (If the Sales Executive Club hears of my talking this way, I'll be asked to turn in my card and badge, and forever stay away from the Roosevelt on Tuesdays.) Twenty per cent, then, are performing the sales manager's function properly, with the right balance between "planning" and "doing". These are the sales managers who have reconciled the selling function with the management point of view, and who can be depended upon to establish realistic marketing objectives together with well-conceived plans to achieve them. Fortunately, this latter group is growing, and we can hope that it will eventually represent the majority of sales managers.

What insight does this brief character analysis give us in appraising the market objectives, sales plans and forecasts prepared by the three types? What are their limitations and what questions can we ask of each to guarantee that all bases have been covered? What general questions should we ask of all of them?

Usually, but not always, you will find the extrovert sales manager somewhat more amenable to constructive criticism than the inside, chairbound sales manager who is apt to be on the defensive. Of course, it goes without saying that whatever the individual, the procedure of delving into somebody else's work and making suggestions thereon calls for considerable tact and patience.

The chief shortcomings of the forecast prepared by the active optimist is that it is apt to reflect this optimism by overstating probable sales, and it may not be founded upon well-thought-out, long-term market objectives and carefully prepared sales plans. To fathom the degree of fundamental soundness, then, we must ask some rather searching questions that lead him to review personally the market objectives, consider the thoroughness of his sales planning and justify or revise his forecast. Here, for example, are some matters the budget executive might review with the sales manager:

1. What are the company's long-range market objectives?
    a. In terms of over-all sales volume?
    b. In terms of share of the market, by types of products?
    c. In terms of market stability?
    d. In terms of distribution efficiency?

2. What significant changes in the market and in the competitive situation are anticipated for the forthcoming year?

3. Have we made market analyses to discover trends and verify our position in the market?

4. What specific sales plans have been made, not only to maintain our market position, but to increase our share of the total?

a. Are we planning for greater market penetration through increasing or improving our sales force; through improvements in our distributor organization or through increased advertising and promotion?
b. Are we planning to enter and develop new markets with our existing products or new products, and if so, how?

5. How does the forecast check with the long-range objectives?

6. How does the forecast check with past performance both as to dollar sales and share of the market? Have internal records been analyzed to discover possible trends?

7. Have standard sources of business information been used in evaluating general business conditions and their possible effect on company operations?

8. Do product sales show any correlation with specific business indices?

9. Will the projected sales result in maximum profits?
   a. Do we know our costs of distribution by products and customer size?
   b. Would any other combination of sales efforts result in higher profits despite lower sales?
   c. Can we increase net profits by raising or lowering our prices?
   d. Do we know our net profit on each product?
   e. Perhaps we can eliminate the unprofitable ones from our line? What effect would an incomplete line have upon total sales?

These are only a few of the actual questions we might raise, but they are all designed to fill in probable gaps in the sales manager's analysis and to start him thinking along more scientific planning lines. We can probably assume that his own innate feel for the market based upon close contact with salesmen, customers, and competitors is fairly good.

It is in this latter area that we must question the chairbound sales executive very closely to assure ourselves that our market objective, sales plans and forecast are not the ivory tower product of intellect alone. A conservative sales program may be more realistic only in the sense that it is more easily attained. Setting goals too low can result in a low-pressure sales effort and deny us sales and profits that are rightfully ours. It can also cause us to lose a competitive position which might be extremely difficult and costly to regain. So we ask the second type of sales manager questions which we hope will stimulate him to acquire a more intimate first-hand acquaintance with customers, the competitive situation, and market conditions generally.

First of all, as in the case of the extrovert sales manager, we start with questions as to basic market objectives, anticipated changes in market conditions, the nature of our market analysis and sales plans, and how the projected plan will help us to reach our objectives. Then we proceed to ask:

1. Have all sources of market information and opinions been utilized in preparing the forecast? Have our salesmen participated in the estimates? What are our important customers' buying plans?

2. What do both actual customers and prospects say about our products

and service? Could we increase sales by minor or major product improvements? By improved customer service?

3. What are our competitors doing? What do customers and prospects say about their products and service?

4. How do our salesmen and district managers compare with those of competitors as to quality, effort, and morale? Do sales performance standards accurately measure output of individual salesmen? Could output be increased through an incentive compensation plan?

5. How good is our distributor organization? Can we tap new markets by using other channels of distribution? Could we increase sales through concentrating our selling efforts more selectively?

6. How does our sales promotion and advertising stack up against our competitors? Are we using media and methods that reach the individuals with buying influence in customers' organizations?

These, too, are typical questions rather than a blow-by-blow account of our discussions with the chairbound sales manager. If they result in the hoped-for response, they can lead to a better appreciation of market influences. First-hand contacts with customers, distributors, and competitors can give new perspective to the sales manager's thinking.

As regards the ambivert or balanced type of sales manager, the chances are that you will find him fortified with the answers to any and all of the questions I have suggested for the preceding two types. After one or two "feeling out" sessions, you will probably get down to a narrative discussion basis with him wherein important facts relative to the forecast are quickly reviewed and any necessary adjustments readily agreed upon.

By now, whatever type of sales manager you are dealing with, you've come to know him pretty well. When the time comes to review his budget performance, you have a better understanding of his problems, and he is quick to appreciate that he is being measured against a standard he helped to establish. The check also stimulates him to keep abreast of market conditions in order to evaluate his department's performance.

Perhaps a change in plan becomes necessary because of nonmarket factors. Rising production costs may be eating into your planned profit and a price increase seems the only answer. Once again, all elements of market objectives, sales plans and forecasts must be considered in arriving at the proper combination that will result in the best net profit. Your sales manager will again examine each factor affecting sales and the effect of each possible change upon net profit. And, once again, you will have to be there with all the assistance you can offer. Only by such cooperation can you be sure that you are planning for maximum profit and that you are proceeding toward that objective on schedule.

In conclusion, I would like to emphasize the importance of knowing your sales manager, his strengths, his weaknesses, and how he arrives at his definition of market objectives; how he plans and how he establishes his sales forecast. There is considerable room for improvement in sales planning, and you gentlemen can be of great assistance in helping your sales organization to help themselves. The benefits

I think are obvious. Selfishly, you have little alternative; for the sales forecast is the basic factor in planning the company's financial requirements, scheduling production, purchasing materials, and determining your personnel needs.

Having mutually established the sales objective, see to it that your sales manager is given the proper support to do the job. Appraise his plans, but back him up after his plans are accepted. Plan for a profit, but be sure that you have considered the effect of changing sales plans upon the possibility of reaching your objective.

As Bob Hope frequently does on his radio programs, let me give you a subtitle to my talk today; Market Objectives, Sales Plans and the Budget OR A Plea for Closer Liaison and Better Understanding Between the Budgeting Executive and the Sales Manager.

DEVELOPING AND INSTALLING A BUDGET PROGRAM

Arthur P. Meier
American Hard Rubber Company

Mr. Allen H. Ottman, Vice President of the American Hard Rubber Company, was scheduled to present this discussion, but was unable to do so because of illness. Mr. Meier substituted for him, using for parts of the presentation material from Chapter 3 of the Corporate Treasurer's and Controller's Handbook, which was written by Mr. Ottman. A condensation of Mr. Meier's remarks is given below.

Developing and installing a budget program is not a quick or easy task because of the technical and educational problems that arise. However, any budget program should result in considerable savings.

The first question that has to be answered is: How do we start the program, and what benefits may be expected, which will offset the cost of its installation and continued operation?

Pre-requisites for budgetary control

Success of the installation depends upon:

1. The wholehearted cooperation of those concerned

2. An adequate chart of accounts and cost system

3. The establishment of definite objectives for all phases of the business

4. Punch-card equipment for flexibility (if volume warrants)

5. Patience during the installation period

Potential benefits of the program

A comprehensive budgetary control program can:

1. Standardize organization as to size, and character for a given volume of business.

2. Standardize managerial reports, providing the right kind for the right people.

3. Standardize accounting, through emphasis on -
   a. Manufacturing to stock rather than manufacturing to order
   b. Reduction of number of products by elimination of loss items through "selective selling"
   c. Standardization of process and operations.

4. Standardize production control by provision for master planning, scheduling and follow-up.

5. Standardize sales efforts through -
   a. Selective selling, based on a study of customer and product profit potentials
   b. Marketing research.

6. Standardize personnel control through merit ratings, incentives, training plans, and specific statement of responsibilities.

7. Make possible the establishment of long term policies

8. Improve co-ordination of all activities, thus making possible more effective use of manpower, materials and machines.

9. Point up the degree and type of modification needed in current plans before final financial statements are prepared, and indicate the exact avenues through which such modification may be made.

Installation time

It usually takes three years to install a complete budgetary control program.

The first year is devoted to the installation and pilot run, the second year, to modification and the complete run. In the third year operation on a routine basis begins.

Major steps in establishing program

The first step is the assignment of the responsibility for development and continuation of the budget program. This function should be entrusted only to a major corporate executive, one preferably reporting directly to the chief executive.

The second step is the preparation of forecasts to determine whether, and to what degree, the long range programs of the company are feasible.

Finally, provision is made for setting up budgets, based on the forecasts, to determine exactly how the company must operate in detail over a limited period of time to achieve its objectives.

Budget officer's duties

The duties of the budget officer may include the following:

1. Developing the budget program to be followed, including the manual of instruction covering the approved method and procedures which implement it.

2. Supervision of the Budget Department personnel, and such other personnel as may be "loaned" to it during the budget preparation period.

3. Design of budget work sheets and issuance of instructions as to how, when, and by whom they should be prepared.

4. Determination of the design and type of budget reports, and issuance of instructions on how, when, and by whom they should be prepared.

5. To review all budget reports issued, determine the reason for variances, and recommend corrective action to those responsible. If corrective action is not taken, report such failure to the next higher level of authority.

6. To act as chairman of the Budget Committee, which should include the chief executive and the head of each primary functional division (sales, manufacturing, finance, etc.). This Committee would review the overall company budgets before installation, and review the progress of the company toward the realization of budgets at least once each month.

7. To advise the chief executive and functional heads concerning performance compared with the budget.

8. To report to the chief executive any serious failures to operate in accordance with approved budgets.

Forecasts

Mr. Sargent has very ably discussed the development of sales plans and preparation of sales forecasts.

After a long-range sales forecast has been made, it can be used as a basis for preparing financial forecasts of earnings, capital expenditures, working capital and cash. Thus, a long-range operating plan is developed and the objectives are set which serve as a guide for budgeting operations in the period immediately ahead.

The sales budget

The sales budgets constitute the basic foundation upon which the budget program is constructed. Only if the sales budgets are correctly stated in terms of unit and dollar volume which can be realized during the budget period, can budgets of cost and expenditures necessary to realize the budgeted sales volume be developed on an accurate and effective basis. It follows, therefore, that the establishment of the sales budgets must be a matter of vital concern to the top management of the company, and that steps should be taken to set up realistic sales budget goals.

Types of expense budgets

If volume can be forecasted with a high degree of accuracy, fixed budgets of expense may be used. In other cases, particularly for a company manufacturing highly styled items or operating on a job order basis, the use of variable or flexible budgets is indicated. These budgets provide for the variability of expenditures with the level of operation.

Many companies use a combination budget program. For example, a company subject to uncontrollable production delays (which do not affect sales) might use fixed budgets for selling and administrative expense and variable budgets for production expenses.

Budgets to be prepared

There is no single budget program that will fit the needs of every business.

Each company must develop a program tailored to its own needs.

In a manufacturing enterprise the key budgets usually include: Sales in dollars and units, production in units, direct and indirect cost of manufacture, selling and administrative expense, and profit and loss.

A complete system also provides for budgets of capital expenditures, cash, and the entire balance sheet.

Editor's note: A discussion of each of the budgets commonly used will be found in the reference mentioned at the beginning of this summary.

Conclusion

The number and type of personnel required to install a budgetary control system depend upon the size of the company, and the diversity of its plants, processes, and products.

For a budget system to achieve its prime objective of control for profit, it is necessary to have clear-cut lines of responsibility, good planning, and an organization educated in the preparation and use of budgets.

The budget system consolidates and integrates the individual plans for all segments of the enterprise, and utilizes these plans for control purposes. Thus, the full benefits of co-ordinated planning can be achieved.

THE SCOPE OF BUSINESS FINANCE

Alvin Brown
Vice President
Johns-Manville Corporation

Most people have a pretty good idea what a production man does and what a sales man does. They are much less likely to have a very clear idea what a financial man does. I am sure some of you have answered the question, What's your line? by saying you are a financial man, and then seen a baffled look spread over your questioner's face: a look that could only mean, Well, what do you do? That is not confined to the man on the other side of the street, either. Even those near and dear to us do not always understand us.

When I was invited to talk about this question, therefore, it seemed well worth doing.

I hasten at the outset, nevertheless, to admit that I speak only my own ideas. For a reason I shall mention presently, there seems to be no natural definition of the scope of business finance. That leaves everyone to make and apply his own definition. Perhaps, out of practice, some day a consensus will come. I doubt if there is one now.

For example, would you call taxes and insurance a part of the finance function? In most companies, I think they are associated with that function. True, indeed, taxes are a charge upon income, or a taking of income, according to your point of view or the kind of tax. But so also are all kinds of expenditure. Insurance is a protection to income, but so are the watchmen who guard a plant. Both affect the financial result of operations, but so does every other activity of a business enterprise.

Therein, I suggest, lies the key to the lack of natural definition. Overlay it with euphemism as people may, the basic purpose of a business enterprise is to make a profit. Of course, the self-respecting company wants to make its profit only in ethical, becoming ways; and, of course, it wants its people to be happy and comfortable in their jobs; and, of course, it wants to be useful to the public: but, after all, these are not charitable purposes; they are all related to the company's basic purpose to make a profit. The company's whole aim, in other words, is financial.

Everything a company does is financial. That is because everything a company does affects its profit. Do you doubt that? Well, how does a company gain its purpose? It does so by doing things that contribute to the purpose. Each thing done calls for a decision. People throughout a company are making decisions every minute of the day. Some may be making great decisions; some, very small ones: but every one affects the purpose of the company, even if it is so small as a clerk's decision to do a thing in a better or worse way. The purpose is financial; every decision affects the purpose; every decision, therefore, has its financial aspect. Every activity of the company is financial.

Finance, therefore, pervades everything. The finance factor exists in research, it exists in production, it exists in merchandising and selling. Every venture made by research in developing products, every expenditure made by production for labor and material, every decision made by merchandising about prices and markets, and

every activity undertaken by selling--every one of these acts is an exercise of finance as well as of the operating function. No function can be divorced from its financial implications.

We see, therefore, how we have to draw a line, not merely between finance and other functions, but between the finance function--the finance speciality--and the financial viewpoint in general. A neglect to draw this line can well be supposed to cause the frequent confusion about what the finance function is. People have no trouble with a well-defined function such as production. But when it comes to things, like taxes and insurance, that are not thought of as separate functions, then there is a common tendency to call them financial merely because they entail expenditures or deal with figures. Of course, I do not mean that such duties cannot be grouped with financial duties, if that is convenient; I only mean we would be better off to see this as a marriage of convenience rather than a blood relationship.

But one can encounter even more extreme cases of misunderstanding due to failure to define the finance function. For example, a sales department, customarily engaged in selling the company's manufactured product, may have occasion to buy some other product to sell along with its own. If, then, any figure work needs to be done in connection with such a purchase, the sales department is likely to call upon the financial man to do it. The sales department reasons; This work is with figures, therefore it is financial. Unfortunately, no one can ever wholly escape from having to deal with figures, and they are no test of financial responsibility. The purchasing specialist would not reason that way. The occasional purchaser will do so because the task is unfamiliar. Truly, it involves figures; truly, also, it is financial--everything is; but it is a financial aspect of the sales responsibility and no part of the finance function proper.

Well, it is about time I gave you my idea about what part of finance--which is everything--belongs to the finance function proper. That is much the same thing as asking, For what part of the whole problem of operation is it good to specialize in finance--to have a viewpoint that is special to the financial aspect and not to any other aspect? My answer is in three parts: first, in providing capital funds; second, in recording and reporting the results of operation in financial terms; and, third, in analyzing the problems of operation.

The first part, you will recognize as the traditional concept of treasurership. Because it is traditional, and because I have no reason to question it as part of the finance function, there is little I need say about it. Primarily, it is a duty of providing funds when they are needed and disposing of funds when they are not needed. With this, as a natural corollary, go the duties to collect the funds owing the company, to have custody of them, and to pay them out as required.

The second part you will as readily recognize as the traditional concept of comptrollership. There is no need for me to say much about this part either. By recording, compiling, and publishing the financial results of operations, the finance function helps everyone in the company take care of the financial aspect of his particular duty.

In contrast to this second part of finance, which deals with the past, the third part deals with the future. It applies intelligence to the data of past operation in order to throw light on the problems of future operation. I call it analysis, but it has no generally accepted name, and I am not sure it is generally accepted as a part of the finance function. I mean that, until recently, it has not often been

thought of as a function at all, but as one of the duties of general management.

For this, I think, the reason is plain enough. Problems demand decisions. Decisions are the most important part of the duties of management. Analysis of problems is the last step before decision. Much of it is just plain thinking about a problem. Management has been accustomed to do its own thinking. Management delegates many functions quite readily, but, because analysis is so close to the basic duty of making decisions, it is one of the last things management thinks of delegating.

Business grows more complex all the time, however, and management's job grows more burdensome. When management lacks the time to think about problems, decisions tend to abandon facts and to deteriorate into snap judgment. Thus the time arrives when management feels the same need of help in analyzing its problems as it did when it created other specialized functions. Delegation of this task is likely to begin in a random way: special questions are turned over for study to whomever may appear to have the time. Eventually, however, management sees the value of having people who will spend all their time on this work, and so, because it deals with earnings in general, it becomes part of the finance function.

At the same time, management is likely to realize that a function useful to itself can be useful to others also; and so the function is broadened to deal, not only with problems confronting general management, but also with the more important of the problems that arise in all phases of operation. In its complete development, the finance function is commissioned to discover problems that have not been identified by others but should be.

I define financial analysis as the study of a company's problems and actions in order to find out what further actions will contribute most to the company's earnings.

I would guess that only a minority of companies have recognized the need of specialized analysis in its full extent of usefulness, but we can see that recognition growing.

To an extent, of course, this work overlaps that of other people with particular operating responsibilities, because they are equally concerned with the financial aspects of their responsibilities. But the overlapping is justified by the advantage of having a specialized financial approach.

Thus, in dealing with problems, the financial analyst acts as a sort of second wave of attack. If the man who does an operating job is alert to its financial side, no analysis by the finance function is needed; and, if this were true at all times of all operating men, the finance organization need not have this part of its duty. However, in the nature of things, operating men are devoted to the operating side of their problems, and it is too much to expect them always to keep their eye on the dollar. This is no criticism; it is just human nature. The finance organization can be useful, therefore, in keeping a broad view on all that goes on, making studies of operations from a financial viewpoint and supplying such studies to operating heads when they show a chance of improvement.

There must, of course, be some limit on the extent of this duplicate approach to operating problems. It is for general management to judge what this limit should be. They will judge what extent of effort will be useful -- how much, in other words, will pay for itself--in applying the financial view-point to the actions that will

be (or should be) taken, both by general managers and others.

These three things, then--funds, financial information, and analysis--comprise, I think, the useful scope of the finance function.

Perhaps it is just as important, in describing this scope, to identify some things that are not, as I believe, part of the finance function. I have already mentioned taxes and insurance. Taxes are not specially financial. The same can be said about insurance.

I hope I will not shock you if I say that budgeting is not a part of the finance function. Budgeting is a thoroughly distributed duty. A budget is first a proposal to spend money, coupled in many cases with an undertaking to get income as the result of such expenditure; when approved, it is an authorization to spend and an acceptance of the undertaking to get income. Such a proposal can have no rational basis unless made by the man who will be responsible for spending the money and getting the income; and an approval is meaningless if by anyone but the responsible supervisor. Budgets, therefore, if truly such, are made by all the people who spend money.

Naturally, on the other hand, I am not saying that financial men have nothing to do with budgets. Managers cannot be expected to have the time to study budgets in detail. They need someone to do this for them, and this work is one phase of financial analysis. Along with that work, it is natural for budget men to assemble and consolidate the budgets prepared in different parts of the company.

A company also needs financial forecasts of operation, which are not at all the same thing as budgets. As I have said, a budget (at least, as I define it) is at first a proposal to spend money; when approved, it becomes an authorization to spend money. Common experience tells us, however, that money is seldom spent in the exact amount authorized: expenditure may be more or less. A forecast, on the other hand, deals with realities of expectation: it undertakes to say what <u>will</u> be spent, regardless of authorizations. I would be somewhat surprised to see a forecast in the exact amount of related budgets, and I would be inclined to feel the coincidence ought to be explained.

So forecasts, too, are a proper object of the function of financial analysis. But the budgets themselves are no part of the finance function, except budgets dealing with the expenditures of the people engaged in that function.

I hesitate to talk about the organization of finance, because organization is something I think should be applied in the light of the particular circumstances of each company. However, when we identify three parts of finance, that naturally suggests three units of organization. Specifically, that would mean a separate department for financial analysis, just as there are likely to be separate departments for the other two functions.

Analysis of budgets is a special phase of analytical work, and this in turn suggests a separate unit within the analytical department. Its work with budgets ought also to qualify the unit as the best forecaster of such things as earnings and assets and liabilities. Doubtless there are other kinds of analysis this unit can also do best because of its budget background.

For kinds of analysis not related to budget work, however, probably the depart-

ment should have other units.

This, then, is my idea of the scope of finance. Clearly as we may distinguish some parts of it, however, it may be vain to expect there will ever be complete agreement on an exact dividing line. This is because, as I have said, finance is everybody's interest--each to the extent of the financial aspect of his particular function. Though this leaves some financial duties that, because they are the concern of everyone, must be provided for separately, and therefore are primarily financial, there will be others, like analysis, that are specialized only because it seems useful to specialize, which makes specialization depend on the exercise of judgment. Between these two kinds of financial duty, moreover, there is an intermediate ground where opinion can differ. Customer credits are, perhaps, a good example of this; they do not seem to me to be either clearly financial or clearly a separate function as such.

I am sure it is a mistake to regard the preparation of a budget as the job of anyone except him who is going to spend the money. I am sure, on the other hand, that a company neglects a valuable implement if it does not give specialized atten-to financial analysis. These are reasons why it would be useful to have a better definition of the finance function.

MANAGEMENT OF BUDGETING AND FINANCIAL PLANNING

GENERAL DISCUSSION AND RESUME

The question and answer period which followed the panel discussion of financial planning was an excellent example of the kind of general discussion which so often takes place in meetings of the NSBB Chapters. Many participated, the whole group was vitally interested, and many worthwhile thoughts were developed. A summary of the discussion is presented below.

The request was made from the floor for comment on the advantages of budgeting for a company that is doing a substantial amount of war work. The question was passed to another member of the audience - Mr. Walter Venghaus of Reaction Motors. Mr. Venghaus said:

"We are a research and development organization which does nearly all of its work for the government. Certainly we have lived with this particular problem, and we have been working for five years in developing a budgetary control system. We believe in budgeted operation. We budget every phase of our operation down to the revenue point, and if for no other reason at all, because it avoids sloppy habits of doing business. We consider that we must operate in our business exactly as any commercial business must operate. There is the element of competition in what we do, as there are several companies in the field and only a certain amount of money is available to the government. So, we have sales forecasts. We estimate our activities, and have variability controls for expenditures in all phases of our operation. We attempt to evaluate performance against the amount of money we spend. In other words, we do our best to give the government a good measure for the money that they have spent and that is a very nebulous thing to do inasmuch as it involves work of scientists, physicists, and engineers, with all the rest of our activities subordinate to that phase of our work."

A member of the audience commented on Mr. Brown's emphasis on analytical work. He said that in his company they had been tempted to change the name of the Budget Department to Analysis Department because responsibility for budget preparation has been transferred to operating groups while the budget group has been concerned more and more with analysis of operations.

In response to a request for amplification of his distinction between forecasts and budgets, Mr. Brown said:

"In my concept, budgets are prepared by the men who spend money. Therefore, there is really no budget prepared for the company as a whole. You may take the budgets which, when approved, are approvals of expenditure, and consolidate them. Then you have (if you are speaking of expenditures only) a consolidation of the authorizations to spend money. But the question always arises: Is each of these men who are going to spend money, going to spend the exact amount he obtained approval to spend? We know he won't; we know that expenditures never come out exactly equal to budget. In that circumstance somebody, preferably the budget people in my opinion, takes those budgets, looks at them, considers experience, applies any other tests that it may devise and derives from that work a forecast of what is actually going to be spent."

The view was expressed from the floor that the concept of budgets as an author-

ization to spend money is outmoded. It was said that the purpose of budgeting is to plan how to get money. The process starts with sales planning in dollars and units. Then a production schedule is established. Plans are made to obtain this production with minimum expense and, therefore, maximum profit. These plans are incorporated in the budget. Thus the budget becomes a device for reducing expenses and increasing profits.

In commenting on this view, Mr. Brown said:

"I didn't mean to imply that a budget is limited to amounts of money that are going to be spent. I think that a budget also includes an undertaking in many, or most, cases to realize income. Divested of all fancy words, I'll have to insist upon my belief that that's all there ever is in a budget when it has been reduced to financial terms: the expression of an undertaking to gain income and the request for an authorization to spend money, the difference between which is earnings."

An inquiry was made concerning the use of budgets and forecasts in Johns-Manville. The questioner stated his understanding that the forecast is the Budget Manager's estimate of what is actually going to happen and that it is expected to differ from the sum of the budgets prepared by the operating divisions. The question was: "How do you measure the division's operation if the budget is not in line with what is considered realistic?" Mr. Brown replied as follows:

"A division's budget is an undertaking by that division to realize a certain amount of income and a request for authorization, which becomes an authorization when approved, to spend certain sums of money in realizing that income. Its activities are measured by that budget, but that doesn't mean that our Budget Manager, if he thinks they aren't going to do just what they have received authorization for, is prevented from saying in his forecast just what he thinks is going to happen. Rather, I should say it is his duty, when he makes a forecast, to say what he thinks is actually going to happen, regardless of the budgets. He takes responsibility for the forecast and the division has responsibility for the budget."

The question was raised whether any mechanism has been developed for measuring the effectiveness of the Finance Department. Mr. Brown replied that there are many ways to measure performance in a financial organization, but there is no simple rule which may be applied generally. In the Analysis Department, the basic consideration is the character and number of useful analytical reports that are made.

Comment was requested on the validity of the salesmen's forecast as a basis for the total company forecast. The questioner expressed the view that since salesmen can't be expected to foresee management policy, salesmen's estimates should be used with discretion. It was agreed that they should, but the question was raised: "How would you go about selling the sales plan to sales personnel if they have little or no voice in establishing it?" Mr. Sargent said: "We want the salesman's estimate, all right, but we also want to get across to the salesman that the company has plans too, that it is a combination of what he thinks he can sell and what the company is going to do that produces the market objective." Mr. Meier added that, in his company, they develop the sales forecast on the basis of salesmen's estimates, after screening by sales management and by the budgeter who uses an economic barometer as a guide.

Mr. Brown was asked whether he thought the financial executive should be a member of the Executive Committee. He replied that he does not believe in executive

committees and gave his reasons as follows:

"I'm afraid my ideas on organization are unique. I am going contrary to the modern trend, but I may say parenthetically I concede no virtue to anything merely because it is modern. There is a definite trend toward reliance upon committees in organizations that I believe to be, generally, exceedingly unwise. There are times for the representatives of diverse interests in a company to come together and discuss something. Please don't think I am saying that's wrong. But a committee tends to waste time and talent. Now, I think the term 'executive committee' is inconsistent in itself. A committee's useful function (when it has one) is to deliberate, to exchange ideas, to seek devices. Executive means to carry out something, to execute. If there is one thing a committee is ill-suited to, it is 'executing'. So, I don't know what an executive committee does."

Mr. Meier was asked to comment on the role of the budget executive in reconciling differences of opinion. He said that in dealing with such problems the budget man must use utmost tact. Capacity for diplomacy is one of his most important characteristics.

Amplification was requested on how to "sell" a budget program. The importance of top management acceptance was stressed, but it was added that we cannot expect any group of executives to become budget conscious all at once. The budget executive often has the problem of gradually building up the program and establishing its value through his comments and reports.

Reference was made to Mr. Brown's statement that budgeting is not a part of the finance function. The question was raised whether a budget is a good budget if it is not subjected to financial analysis. Mr. Brown replied:

"Why, it may be good budget regardless of the analysis. Analysis is devoted to it to find out whether it is a good budget. The reason I said we needed a Budget Manager - and I hesitate to say this because you may find many other reasons why a Budget Manager is needed - is because the General Manager hasn't the time to analyze. He gets a Budget Manager to analyze for him. In other words the budget may be good, but how does the General Manager know it? The Budget Manager tells him."

Apparently, from Mr. Brown's earlier remarks there had been some doubt as to whether the Budget Manager is part of the financial organization in Johns-Manville. Mr. Brown said definitely that he is and that his work is one phase of financial analysis.

Mr. Bunge presented a resume of the entire session which is summarized in the following paragraphs:

"There has certainly been agreement among the speakers today that budgeting is a coordinated, a cooperative sort of thing; that everyone who spends the company's money and collects the company's funds should make the preliminary estimate of his own budget, and that the budget department should render expert assistance in this phase and coordinate and analyze these estimates. This is in keeping with the definition of the "financial function" as defined by Mr. Brown, since the Budget Department deals with the financial aspect of the various and divergent types of activities and functions within the company.

"Actually, budgeting itself isn't very new. If that surprises you, consider this: Along about 1500 or 1800 BC one of the great monarchs of that day called

Pharaoh had a budgetary problem, and he called in a budget expert. That expert was Joseph. If you remember the problems of the seven lean years and the seven fat years, you will agree that he did a pretty fair job of budgeting the grain of that day. What is new is the techniques of budgeting, the way we go about it, the way we apply it, the way we get all levels of management to work together on this thing, and the use of long-range planning. (Of course what Joseph did was long-range, too, but we had forgotten much of it in the years between.) All of these techniques combine to enable us to make good budgets today.

"Actually there are quite a number of companies that don't realize that they budget. Management itself is sometimes unconscious of the fact that actually it does budget. In my own humble opinion every management budgets, whether it is done formally or informally. The budgetary function is accomplished in some way, because if management didn't plan ahead -- and that's about what budgeting is -- how could it set policies and how could it set prices; how could it even estimate the cost of a government contract? So it seems to me that we all budget. If we do it formally, if we do it scientifically, if we put it down on paper where we can get a good look at it and coordinate it and evaluate it and talk it over in group meetings (committee or not), then I think that we have certainly accomplished a very great deal. And we are doing something else that is quite important. We are developing management replacement material.

"Someone has said that absolute marksmanship isn't an essential of budgeting. There are things, not provided for, that happen throughout the year. I know that we haven't gotten into the subject of budget changes, and I hope we don't because it would take the rest of the evening. There is, however, some apprehension about "missing" the budget. But even if you miss, you have developed a road map, as someone said this morning, and thus can measure the deviation from a definite plan. That is management by exception, and that certainly saves a lot of management's time, and is another advantage of budgeting."

3

CASE STUDIES IN BUDGETING

CHAIRMAN'S OPENING REMARKS

William H. Harr
Lever Brothers Company

In the earlier sessions of this conference we have heard discussed the economics of planning and the objectives, installation, development, and scope of budgeting. Today we give it substance in the form of specific applications of budgetary principles and techniques.

This morning's topic, "Case Studies in Budgeting", permits us to observe at first hand the development and effective use of budgeting for profit as it operates in six large diversified corporations.

The first half of our session is devoted to "Profit Budgeting"--a research project in cooperation with the Commerce School of the University of Wisconsin. The companies represented in this study, through their budget executives, are Allis-Chalmers; Snap-On-Tools; and Kimberly-Clark. This research project was planned and conducted by Dr. William D. Knight, Associate Professor of Commerce and Director of Business Research and Service of the University of Wisconsin. He is justly prominent for his authoritative lectures and writings in the field of business and finance.

We are privileged this morning to have Dr. Knight with us to lead the discussion. With the assurance of a most interesting presentation of these case studies, we are pleased to introduce Dr. Knight and his panel collaborators who have demonstrated the advantages to be gained through the cooperation of industry with our universities.

PROFIT BUDGETING

INTRODUCTORY REMARKS

Dr. W. D. Knight
University of Wisconsin

This panel on profit budgeting held a dress rehearsal before the Milwaukee Chapter about a month ago. On that occasion we attempted to reach an agreement as to the objectives or purposes of budgeting, the functions which make a budget system of value or use to management. It was agreed that budgeting was concerned with planning and coordination, with control or follow-up, and with what we have labeled a library function--a source of data and a method of analysis for use in studying special problems or proposals for management action. There was, however, considerable difference of opinion among the panel members as to how these points are related to each other, and as to where the emphasis should be placed in a brief demonstration of the usefulness and value of budgeting to management.

The conclusion which was practically thrust upon us (I believe it was Mr. Cain who put it into words) was that there is no single, one-best budget or budget system; that the first necessity for a good budget is that it be tailor-made, that it be designed and developed to fit the circumstances and the operations of the company which is to use it. What we are doing then, in the three cases to be presented this morning, is to have a look at three specific companies; to see with respect to each company, the distinctive features of that company's budget; to see how the budget has been developed to fit the circumstances of the particular company and the needs and desires of its management.

Our second and final task is then to say with respect to each company, and to all three of them, of what value or use budgeting is to management, how management can do some things with a budget which it could not do without one, or how it can perform the function better if a budget is in effect. To make this last task as specific and concrete as possible we have been asked to consider the question under conditions of a sharp drop in sales or business conditions. The ultimate goal of this panel is then to attempt to state, under a specific set of circumstances in three different companies, the value of profit budgeting to management.

As we proceed with the three panel presentations it will be helpful for the audience to keep in mind several limitations under which these presentations are made. First, we shall be talking only about profit, or profit and loss, budgeting as distinguished from balance sheet budgeting with its components of cash and capital budgeting. Second, each speaker will be concerned primarily with only the distinctive features of his particular budget system. His failure to mention some phase or aspect of the program, or his mentioning it only briefly, does not mean that it does not exist or is not important. Third, for purposes of sorting out and summarizing these presentations, it will be useful to limit the various purposes to two very broad and all-inclusive categories: cost control and, what we may somewhat arbitrarily call, product-line control. By cost control we mean the familiar use of variable standards as a measure of efficiency of operations; by product-line control we mean the relation of budgeting to a broad range of management policy decisions relating to such matters as price policy, product development, advertising, sales promotion management, production methods and even plant and equipment.

As the three presentations proceed you will, therefore, be asked to consider, first, the distinctive features of each system of profit budgeting as it relates to the particular company, and, second, the usefulness of that system in relation to the two broad purposes of cost control and product-line control.

Since our first speaker is your retiring national president, I presume that both he and his company are familiar to most of you. The Allis-Chalmers Company has two main divisions, the tractor division and the general machinery division. The tractor division manufactures construction and farm equipment as well as tractors; the general machinery division is advertised, I trust reliably, as one of the big three in electrical machinery and biggest of all in its range of industrial equipment. In its main plants in Milwaukee and in 12 branch plants throughout the United States, in Canada, and in England the company has a total employment of about 34,000. Because of the size of the Allis-Chalmers Company and the diversity of its products the company's budget system must be comprehensive and diversified with many features relating both to cost control and to product-line control. The task assigned to Mr. Bunge this morning is, therefore, necessarily out of proportion to the time allowed him.

We have on the panel one more retiring president and as a matter of protocol I should present him next. Setting protocol to one side, however, I want to present next a man who as Controller of a young, progressive company out in Kenosha has, to the best of my knowledge, never been accused of retiring from anything. The Snap-on Tools Corporation is a leading manufacturer of a line of socket wrenches and related tools for sale to garage and airplane mechanics and to industry. The company has four plants and 42 sales branches with a total employment of about 2,000(?). Because of the size and homogeneous nature of its products, Snap-on does not have product-line problems of the same type as Allis-Chalmers. The company's master budget does, of course, have numerous applications to management policy decisions in such fields as sales and production. Nonetheless, in a brief presentation such as this, the distinctive features which emerge relate to the cost control aspects of budgeting especially in the areas of direct labor, general administration, and sales.

We come now to our third and final speaker, Mr. William McGuire, Budget Director of the Kimberly-Clark Company, and retiring president of your Milwaukee Chapter.

The company itself can hardly be said to be retiring, however, when it is pointed out that the total of its gross fixed plant and investment in affiliates rose from $65,000,000 at the end of 1945 to more than double that figure, or over $130,000,000 at present. Because its principal consumer products, Kleenex and Kotex, are distributed by International Cellucotton Products Company on a long-term contract basis, its products are perhaps better known than the company itself. The other important products in the creped wadding division are insulating and packaging materials. In the book paper division the company is one of the largest producers of a broad line of magazine, catalogue and printing papers. Two of its affiliates are important producers of newsprint. In back of these products are the facilities to produce pulp for all its products. The company operates ten plants east of the Mississippi in the United States and in Canada, and employs about 10,000 people. It differs from Allis-Chalmers and Snap-on in that it is in a process industry and lies between them in size and diversity of products.

The Kimberly-Clark budget system resembles the Allis-Chalmers system in the extent of its product line control, and in its confinement of variable budgeting to gross profit. It resembles Snap-on in that it has a standard cost or cost-standard

system integrated with its budget. The Kimberly-Clark budget differs from both of the other budget systems, in that it is a process industry and that cost standards, set by the standards department, play a fundamental role in both its cost control and its product-line control features. Since the two previous speakers give considerable emphasis to the use of variable budget standards for cost control purposes, and since what is probably the most unusual feature of the Kimberly-Clark system relates to product-line analysis, Mr. McGuire gives primary emphasis in his presentation to what I have been calling product-line control.

PROFIT BUDGETING

CASE STUDY "A"

Walter R. Bunge
Allis-Chalmers Manufacturing Company

In practically every enterprise, costs and profits tend to fluctuate with volume, but not in proportion to volume. If billings are $200 million and costs are $180 million, then the costs will not be $90 million if the billings drop to $100 million. Similarly, if profits are $20 million with billings of $200 million, they are not likely to be $10 million with billings of $100 million.

We know what they will not be, but do we know what they will be? This gets back to that basic tenet of flexible budgeting, the segregation of costs into those that do and those that do not fluctuate with volume: variable and standby costs. A great many companies recognize this principle, and they segregate their costs on the basis of past experience. We do not believe that that is a sound principle in our industry. There have been too many changes in the relationship of the various elements of cost to each other. The purchase of new and more efficient machines, the development of better techniques and better materials and even the extent of subcontract work or the change in the mix of products will affect the relationship of the various expenses to each other and to volume.

We like to believe that we do things better today than we did last year, and the year before that, and we know that we do things differently. For that reason our variable budget is based upon the future instead of the past, and since we do not know for certain what the future will bring in volume, we establish actual budgets at <u>three levels of volume</u>. The first of these levels is the anticipated volume - let's consider that as 100%; the second volume level is one-third higher, or 133 1/3%; and the third level of volume is one third lower, or 66 2/3%. That gives us a range of operations from a high of 133 1/3% to a low of 66 2/3% or just halfway down to the zero point. This is quite a wide range.

Budgets are very carefully established at all three levels by all those who spend the company's money, including the foremen. To do this, it is necessary to plan ahead exactly how many men will be required at each of those three levels for each category of personal service, how many shifts will be operated, what the supplies and general expenses and other items of expenses will cost at all three levels.

It is possible at that point to visualize or actually to draw a graph showing the line of total expenditures passing through the low, the anticipated, and the high levels of volume. It is also possible to express this line of cost mathematically. In either case, it will be found that there will be an element of continuing or standby expenses and also an element of expenses which increase proportionately as volume increases. Our budget is based on the premise that expenses at any reasonable volume should and will fall along the line which connects the cost estimate points at the high and low volumes.

In practice, of course, the computations are made mathematically instead of graphically. It is unnecessary to go into the details of the techniques at the moment; most of you are familiar with them anyhow. The important point is that we have established a budget on the basis of what is actually going to be done in the

coming year, and we have established it in such a way that the expenses at any reasonable volume can be projected: not only at the three basic points, but anywhere along the line of cost.

Every foreman (to use him as an example) has preplanned exactly what he will do in any contingency. The budgets of every department have been coordinated and adjusted to a well-fitting and smoothly-operating whole at any reasonable level. Thus a pilot model of the year ahead has been created on paper. Furthermore, this pilot model can be adjusted to any reasonable level, and its operation at that level can be observed in detail. During the year, when actual operations are reported together with the budget, any deviation from the budget can be instantly spotted and much more easily corrected than with other types of budgets, because the foreman has already determined what he can do under that set of conditions.

Proof of the system is the way it works out in actual practice. Let me give you some examples of actual cases from within our own company, which occurred since World War II. One operation with a volume of 108% of its anticipated level had manufacturing expenses of 97% of the budget. It should be remembered that the budget itself, being flexible, increased with volume but not in proportion to volume. In the same year there was a period when another operation was running at only 46% of its anticipated level. Even during that time, its expenditures were 97% of its budget allowance at that low volume. Another operated at 101% and had expenditures of 99%. Still another works was very considerably above the anticipated level and its expenses were 104% of its flexible budget. That 4% was readily accounted for because the very sudden increase in volume forced the hiring of a great deal of green help and the use of some obsolete machinery. It represented the cost of putting both manpower and machinery into efficient operating condition. Of course once that is accomplished, there is a dip in costs which tends to put the average for the year at the budget level.

Naturally, percentages do not always hover about the 100% mark. Things happen such as price increases in steel, and so on. But when they do, they are highlighted, and over a long range there is a marked tendency to stay pretty close to the budget.

It should be quite obvious that this type of budget has a distinct advantage at a time of economic uncertainty and particularly at a time of decline. Ordinarily, there is a strong inertia in operating costs, and statements tend to show higher costs for quite some period before action is taken to bring them into line. This is particularly true when the decline in volume is sudden and unexpected. With this system of budgeting, however, every man who spends the company's money has already planned what he would need in case such a decline occurred, and he is ready. As soon as his production schedule shows a decline he can adjust his operations because they have been planned, they have been approved, and they have been coordinated with plans of other departments. This gives a tremendous head start in cost and profit control.

Budgeting is management planning put down on paper where you can get a good look at it. In this type of budgeting, management's planning reaches deeper into the organization and, furthermore, it is broader in that it covers a wider potential fluctuation in business. It is a very pleasant thing for top management to be able to realize that whatever the volume, within reason of course, men all along the line are already supplied with coordinated and approved plans to fit it, and management has a pilot model of operations that can be adjusted to reflect the conditions of any reasonable level of operations. The key to this system, of course, is budgeting

at the <u>anticipated</u> level and levels far <u>above</u> and far <u>below</u>, and the conversion of those budgets after coordination and approval into a simple budget formula for each operating department.

PROFIT BUDGETING

CASE STUDY "B"

V. M. Cain
Snap-on Tools Corporation

Doctor Knight has mentioned that the products of Snap-on Tools Corporation are a homogeneous line consisting of hand tools. We do not attempt to establish budgets or accounting plans by product line because we have only one line. The pricing and profitability of each unit and group of units is determined on the basis of standard unit costs.

There are some 4,000 items in our line with a relatively stable product mix at any sales level. The principal manufacturing operations performed are drop forging, machine shop operations, heat treating, and electro-plating. With a stable product mix, a forecast of sales dollars can be rather easily converted into production hours for each manufacturing cost center. I have given you this preface to justify the omission from our budget procedures of three factors that are rather common in most other plans: product-line and product-mix budgeting and a unit sales forecast.

Our problem in sales forecasting is one which, in the absence of any standard term, I will refer to as "customer mix." In using this term, I am talking about the proportionate amount of sales to retail buyers, industrial accounts, export accounts, sales to subsidiary companies, government contracts, and others. In our company there is a very marked difference in the selling price to garage mechanics and other retail buyers at one extreme, and for large government contracts at the other. There are, of course, compensating differences in salesmen's commissions, shipping expenses, billing costs, and other expenses. A substantial error in our forecast of the proportionate amount of these sales segments can seriously affect the accuracy of our comparison of budgets with actual results.

Assuming accuracy in the forecast of customer mix, our budget department does not attempt to forecast the sales volume for the year following but, rather, converts the sales level at the time budgets are established, which is quite late in the year, into monthly sales dollars and production hours and uses that level as <u>normal</u> for the year ahead. Starting with that normal expressed in sales dollars and production hours per month as 100 per cent, a series of eleven budgets is projected, up to 150 per cent of normal and down to 50 per cent with increments and decrements of 10 per cent of normal.

The budgets for cost of goods sold, salesmen's commissions, administrative expenses, selling expenses, and shipping expenses vary with sales volume. The first two, cost of goods sold and salesmen's commissions, are direct variables. The latter three, administrative, selling, and shipping expenses, obviously do not vary in direct proportion to sales. It is my opinion, however, which is not shared by all, that administrative, selling, and shipping expenses can and should move upward and downward with sales volume. This may be a situation peculiar to our company, but it is supported by the facts during our 30 years of operation.

The subject of variance or lack of variance in administrative expenses at different sales levels leads to another matter in which I have found a fertile field for discussion. I refer to so-called fixed expenses. I dislike the term; to me it

is an expression of defeatism. While we must recognize that some expenses are more volatile than others, I believe that there are very few, if any, expenses which must irrevocably be classed as fixed in amount. I refer to the expenses usually classed as such - taxes, depreciation, and others. If we are going to truly present a chart-course for management in the event of a downturn of business, I don't think we can afford to retain the term nor the conviction of fixed expenses.

Moving from generalities, I would like to give a brief description of our budgeting for manufacturing costs and operations of sales branches. I will try to confine it to major differences from the plans outlined by Mr. Bunge.

As mentioned earlier, our first step in setting up manufacturing budgets is the establishment of normal direct labor hours for each manufacturing cost center, whereas Allis Chalmers uses direct labor dollars. With this as a starting point, a conference is held with manufacturing management to determine the costs that will be incurred at that production level. The most important person in attendance at these conferences is the department foreman, Others include the chief cost accountant, head of the budget department, and factory superintendent. We spend three to four weeks annually in such conferences.

The determination of costs in the Snap-on budget plan is made by individual items of expense. For some, we get right down to the minute details - the rate of pay for each man, the work that is performed, etc. These individual expense budgets are carried through as such in the reporting and determination of variances throughout the year. This is mentioned as a point of difference between our plan and the "expense grouping" plan used by Allis Chalmers.

After the total departmental costs are determined at the normal level of direct labor hours, the standard departmental burden rate is established by a simple diviion of the total costs by the normal hours.

The next step in the procedure is the projection. The conference group establishes, to the best of their judgment, the amount of expense that will be incurred at each of the five levels above and the five levels below normal. Completion of this budget produces a tool which will determine the point below normal at which unabsorbed factory burden should be incurred and the amount that can be expected if if all actions have been taken as anticipated. The same is true of overabsorbed burden.

I would like to mention at this point that certain items of expense, such as foremen's salaries, premium paid for overtime, shift premiums, and indirect labor, are projected on the step budget plan as contrasted with the straight-line method used at Allis Chalmers. I can't argue with Walter on the effectiveness of the straight-line plan for his company. We feel at Snap-on, however, that with small departments or cost centers the addition of a second-shift foreman, additional mateial handler, overtime premium, and such similar items represent a distinct step upward in costs rather than a straight-line increase. This is an example of the need for tailor-made budgets.

Budgets for manufacturing materials and direct labor are established by the standards department and incorporated as a part of the standard costs. Variances between budget and actual costs of material, direct labor, and manufacturing expense and the causes of them are reported in detail to factory management and in brief summary form in the monthly financial statements furnished to the Board of Directors.

The detailed variance reports furnished to factory management are the basis for action.

Let's swing over now to the subject of budgeting operating costs and profits of our branch sales offices. I feel that we have unique features in this field, but I won't be able to cover all of the details in the time allotted. If any of you have a similar branch organization and are interested in getting more information, I'll be glad to sit down with you privately.

I would first like to describe for you an average Snap-on branch. Visualize, if you can, a store building with, perhaps, 40 foot frontage and 80 foot depth. The front of the building is devoted to offices and a customers' counter, the rear area to stockroom and shipping facilities. The organization consists of a branch manager who is our executive in that area, a fieldman supervising the salesmen, 10 to 15 salesmen or dealers selling direct to garages, industrial accounts, and others in his area, three people in the office and two in the stockroom. We have 42 such branches in the United States and Canada, varying from 10 to 40 salesmen with variations in other factors according to the size of the sales force.

The branch manager has three primary functions: (1) Maximum sales in his territory; this is measured against a pre-determined potential. (2) Administration of the company's business in the area assigned to him. (3) Earning a profit commensurate with the sales volume.

The manager's salary and incentive bonuses are set up in such fashion as to stimulate his desire to reach each of the three goals. He is paid a minor commission on his sales, a flat salary for adminstering the business, and is on a profit-sharing plan.

The target of the branch budget plan is maximum profit at any sales level, such profit to be consistent with good operation of a business. Our first step toward accomplishing this is to establish branch operating budgets for all sales levels which provide adequate allowance for costs and expenses as determined from previous experience and forecasts of the future. These budget allowances are expressed in percentage of the sales dollar. We start out with the lowest average weekly sales that will support a branch operation and project upward at increments of $200 per week in sales to the highest present conceivable weekly sales volume. This is an excellent application of the variable and semi-variable principle with discounts, cost of goods sold, sales commissions, and in-bound freight, falling in the class of straight variables and administrative, selling and shipping expenses in the class of semi-variables. It also illustrates the need for step budgeting, as an increase in the office or stockroom personnel may represent at one step an increase of 33-1/3 to 50 per cent over the preceding budget. These budgets were originally established in conference with district managers and branch managers and are reviewed annually at district meetings to determine the revisions, if any, that must be made.

After the series of budgets is established for the ensuing year, the resultant profit upon which the branch manager's profit-sharing bonus is computed is made a part of his employment contract and is set forth as the minimum profit that he may earn if he is to receive the maximum amount of profit-sharing bonus.

Exhibit 1 gives visually, a better idea of a section of the branch budgets than I could give verbally. Note particularly that the first section is almost a direct variable with sales and that at the level of $6,000 per week in sales there is a def-

inite step upward in the budget allowance for office salaries. That is where it is anticipated that one more clerk will be added.

Assuming sales of $328,000 for the year, which would be in the bracket of $6,200 to $6,399 per week, the minimum required profit is 10 per cent. Exhibit 2 shows the effect upon the branch manager's and the company's earnings at varying profit levels.

A comparison of actual results and budget is furnished to the branch manager monthly in the form of a branch profit and loss statement.

We have used this form of control of branch operations for quite a number of years and have found that present earnings of both the branch manager and the company are greatly in excess of those that were obtained on the same volume of sales during the period prior to the establishment of this plan. There are problems in the operation of this procedure but none that are insurmountable. Some of the more important considerations are these: (1) It must be a plan that applies to all without discrimination; (2) It must be a realistic budget, one in which the branch managers themselves have had a share in preparation; (3) It must be revised annually and special conditions that arise during the year must be recognized and corrected; (4) It must in no way hinder or discourage desirable management action or expenditures.

As mentioned earlier, I will be glad to go into details of the operation of this plan with any of you or answer specific questions in the question period following.

SNAP-ON TOOLS CORPORATION
BRANCH BUDGETS - 1952

	5,600 to 5,799	5,800 to 5,999	6,000 to 6,199	6,200 to 6,399	6,400 to 6,599	6,600 to 6,799	6,800 to 6,999
Sales	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Dealer Discounts)							
Trade Discounts)	23.75	23.75	23.75	23.75	23.75	23.75	23.75
Salesmen's Commissions)							
Fieldmen's Commissions	3.00	2.97	2.94	2.90	2.86	2.82	2.77
Branch Manager's Commissions	.95	.95	.95	.95	.95	.95	.95
Cost of Goods Sold	52.50	52.50	52.50	52.50	52.50	52.50	52.50
Freight & Express - In	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Gross Profit	18.80	18.83	18.86	18.90	18.94	18.98	19.03
Administrative Expenses							
Cleaners & Janitors	.03	.03	.03	.03	.03	.03	.03
Compensation Insurance	.07	.07	.07	.07	.07	.07	.07
Social Security Taxes	.09	.09	.11	.11	.10	.10	.10
Maint - Furn. & Fixt.	.02	.02	.02	.02	.02	.01	.01
Maint - Trucks	-	-	-	-	-	-	-
Light	.04	.04	.04	.04	.04	.04	.04
Water	.01	.01	.01	.01	.01	.01	.01
Social & Personnel Develop.	.07	.07	.07	.07	.07	.07	.07
Supplies	.12	.12	.12	.12	.12	.11	.11
Printing & Stationery	.08	.07	.07	.07	.07	.07	.07
Postage & Revenue Stamps	.19	.19	.19	.19	.19	.19	.18
Telephone & Telegraph	.19	.19	.19	.19	.19	.19	.18
Donations & Charities	.01	.01	.01	.01	.01	.01	.01
Bad & Doubtful Accts.	.04	.04	.04	.04	.04	.04	.04
Membership Dues & Subscrip.	.01	.01	.01	.01	.01	.01	.01
Legal & Professional Services	.01	.01	.01	.01	.01	.01	.01
Collection Fees	.01	.01	.01	.01	.01	.01	.01
Traveling	.04	.03	.03	.03	.03	.03	.03
Unclassified	.01	.01	.01	.01	.01	.01	.01
Rent and Heat	.63	.62	.61	.60	.60	.59	.58
Leasehold Repairs	.04	.04	.04	.04	.04	.04	.04
Insurance	.14	.14	.14	.14	.14	.14	.14
Depreciation	.08	.08	.08	.07	.07	.07	.07
Executive Salaries	1.05	1.02	.98	.95	.92	.90	.87
Office Salaries	1.87	1.79	2.41	2.34	2.27	2.20	2.15
Overtime	.19	.18	.24	.23	.23	.22	.22
Total Adm. Expenses	5.04	4.89	5.54	5.41	5.30	5.17	5.06
Balance	13.76	13.94	13.32	13.49	13.64	13.81	13.97

Exhibit 1
Page 2

	5,600 to 5,799	5,800 to 5,999	6,000 to 6,199	6,200 to 6,399	6,400 to 6,599	6,600 to 6,799	6,800 to 6,999
Balance	13.76	13.94	13.32	13.49	13.64	13.81	13.97
Selling Expenses							
Social Security Taxes	.06	.06	.06	.06	.06	.06	.06
Social & Personnel Development	-	-	-	-	-	-	-
Supplies	.02	.02	.02	.02	.02	.02	.02
Printing & Stationery	.11	.11	.11	.11	.11	.11	.11
Commissions to Branches	-	-	-	-	-	-	-
Advertising	.08	.08	.08	.08	.08	.08	.08
House Magazines	-	-	-	-	-	-	-
Shows & Exhibits	-	-	-	-	-	-	-
Catalog Expense	.13	.13	.13	.12	.12	.12	.12
Branch Sales Material	.09	.09	.08	.08	.08	.08	.08
Traveling	.25	.25	.25	.25	.25	.24	.24
Sales Contests	.04	.03	.03	.03	.03	.03	.03
Sales Meetings	.07	.07	.07	.06	.06	.06	.06
Unclassified	.04	.04	.04	.04	.04	.04	.04
Insurance	.15	.15	.15	.15	.14	.14	.14
Total Selling Expense	1.04	1.03	1.02	1.00	.99	.98	.98
Balance	12.72	12.91	12.30	12.49	12.65	12.83	12.99
Shipping Expenses							
Social Security Taxes	.06	.05	.05	.05	.05	.05	.05
Social & Personnel Development	-	-	-	-	-	-	-
Cartage & Hauling	.01	.01	.01	.01	.01	.01	.01
Freight & Express - Out	.35	.35	.35	.35	.35	.35	.35
Supplies	.08	.08	.07	.07	.07	.07	.07
Printing & Stationery	.01	.01	.01	.01	.01	.01	.01
Postage & Revenue Stamps	.19	.19	.18	.18	.18	.18	.17
Unclassified	-	-	-	-	-	-	-
Salaries - Regular	1.74	1.69	1.62	1.56	1.51	1.46	1.43
Salaries - Overtime	.17	.17	.16	.16	.15	.15	.14
Total Shipping Expense	2.61	2.55	2.45	2.39	2.33	2.28	2.23
Operating Profit or Loss	10.11	10.36	9.85	10.10	10.32	10.55	10.76
Other Income							
Inventory Overages	-	-	-	-	-	-	-
Commissions Received	-	-	-	-	-	-	-
Miscellaneous	-	-	-	-	-	-	-
Total Other Income	-	-	-	-	-	-	-
Balance	10.11	10.36	9.85	10.10	10.32	10.55	10.76
Other Deductions							
Discounts Allowed	.04	.04	.04	.04	.04	.04	.04
Bank Service Charges	.04	.04	.04	.04	.03	.03	.03
G.O. Service Charges	.02	.02	.02	.02	.02	.02	.02
Replacements (Net)	-	-	-	-	-	-	-
Inventory Shortages	-	-	-	-	-	-	-
Total Other Deductions	.10	.10	.10	.10	.09	.09	.09
Profit Before Br. Mgrs. Bonus and Taxes	10.01	10.26	9.75	10.00	10.23	10.46	10.67

Exhibit 2

SNAP-ON TOOLS CORPORATION

EFFECT OF VARYING BRANCH PROFITS ON MANAGER'S EARNINGS

	Budget	Actual #1	Actual #2	Actual #3
Total sales for the year	$328,000	$328,000	$328,000	$328,000
Profit before bonus	32,800	40,000	30,000	22,000
Manager's bonus	8,200	10,000	5,400	-0-
Company profit	24,600	30,000	24,600	22,000

CASE STUDY "C"

W. D. McGuire
Kimberly-Clark Corporation

Before getting into the discussion assigned to me I would like to take just one of those few minutes allowed to tell you, as retiring president of the Milwaukee Chapter, that we very much appreciate the opportunity to make this presentation. We appreciate it most because it gives us an opportunity to present what we think is a good example of cooperation between industry and education. I would like to stress the fact that this type of cooperation is a two-way street. People like Dr. Knight can and do bring to bear upon business practices, and budgeting is just one, an unbiased, logical approach which can help us to weed out the unnecessary methods and procedures which are all too often found in business, particularly big business, even though most of us assume that they are the sole property of government. Coming the other way on the street is the additional knowledge of business problems which can be channeled through people like Dr. Knight into the educational curriculum. Students will be better trained and more quickly usable by industry after their graduation, and the school will have done a better job. So everybody benefits, and I hope that this presentation represents just a small start in a full and complete program of industry-education cooperation under the auspices of NSBB.

Dr. Knight has told you that our description of the Kimberly-Clark system will dwell primarily on those features of our system which have to do with product-line control. However, I must spend just a few moments on how we set our cost standards to show how we use them in our budget.

Our mill cost standards are set annually on three major bases of variability:

(1) T Costs - those costs, such as raw material and process steam, which vary directly with volume produced

(2) H Costs - those costs, such as power and machine labor, which vary with the number of hours operated

(3) M Costs - the monthly costs, the time costs, the fixed costs - call them what you will.

Behind these are numerous bases of variability dealing with particular operations, but after the costs have fully progressed under our process cost system they end up in one of these three major bases of variability.

It is on this classification of costs that we depend for a number of things.

The first thing this classification does is to define the area in which action must be taken in times of reduced volume; that area is in the H costs. There isn't much one can do about monthly costs, at least quickly, and our T costs are almost purely variable and thus go a long way toward taking care of themselves under reduced volume. It is the H costs, or regulated costs as I saw them defined recently, where prompt action must be taken when volume falls off. I am going to slide over that point rather rapidly because it pertains to cost reduction for maintaining profits in

periods of reduced volume, a subject which is well covered by other speakers.

The second is day-to-day cost control. It is our system for calculating the allowable mill cost under varying conditions of operation and is roughly our counterpart of the direct labor hours base of Mr. Cain and the direct labor dollar base of Mr. Bunge. Monthly cost control reports, in which the mill controllable variations are segregated from the staff controllable variations, are distributed to those responsible for cost control.

In exhibit 1 is the final summary report of mill variances for the Niagara Falls paper mill for the theoretical month of September, 1952. All but two of these items are the normal type of price or efficiency variances of which I have shown only a few. So, while I am not going to dwell on our cost control system, we do have one and do use it.

It is at this point that we can begin to consider the Kimberly-Clark product-line control system as distinguished from a cost control system; how, and why it works. I wish as I begin this description that I had the confidence of Henry Kaiser, who, when he was planning to double his aluminum output in one year, was advised to take it easy, that "After all, Rome wasn't built in a day". To which Mr. Kaiser is supposed to have responded "Yes, that's right, but I didn't have that job". I don't mean to imply that the system is overly complicated but if I successfully describe it to you in the next ten minutes, it will be the first time it has been done in such a short time. Anyway it's still early in the morning so let's give it a try.

The same split of costs between M, H, and T which formed the basis of our cost control system is the basis of our product-line control system. By that I mean that it gives us the information from which we can develop individual grade costs. In the case of our product of book paper, which we will be using as an illustration of the system, the grades represent the various qualities and weights of paper within the product line, book paper.

Before the mill cost standards are set, an outline of the product mix and grade mix within products is supplied to the Mill Cost Standards Department. That mix is usually based pretty much on the current grade outline with corrections for expected significant changes occasioned by contemplated entry into a new line or a fairly clear change in trend of the mix of present products.

While the sales volume budget is being prepared and approved, we have been developing the unit selling price, freight cost and other sales deductions by grades. So, when we have our unit mill grade cost and our budgeted sales volume by grades by months, it is a matter of simple extension to arrive at a budgeted gross profit by product by months.

Exhibit 2 shows this calculation for one product, for one month, with the detail for one mill. The budgeted quantities are on the left; the unit selling prices, sales deductions, mill costs and gross profit are ranged across. The total monthly sales, sales deductions, costs, and gross profit for this product for the month are shown at the bottom. The total gross profit budget is simply the addition of this bottom line for all products by months.

The point I want to emphasize is that our gross profit budget is fixed by months. It is not adjusted for volume, price, mix, or anything else. It is $800,000 for the month of September for this product.

In Exhibit 3 we have substituted the actual quantities sold in September by grades. Again an extension of the individual unit selling prices, sales deductions, and costs give us what we call our adjusted budget, by which we mean only that it is a budget based on actual quantities sold by grades. The budgeted gross profit on this actual tonnage is, as you see, $730,000. So before we do anything else let's reconcile that with my statement just a moment ago that our gross profit budget for this product for this month was $800,000. What caused the difference between the two? Simply that we extended the original budget by the original budget quantities and this adjusted budget by the actual quantities. The difference then is a measure of the loss in gross profit due to volume and grade mix, since it was caused solely by the difference between actual volume and mix of grades compared to budgeted volume and mix of grades. The simple calculation is shown at the bottom of the table. That means, also then that any variations appearing in the variance line are not influenced by volume or mix. In gross sales any variance would be due simply to a change in selling price. Here we have not changed selling prices since the budget was originally established. The freight variance can be due to two things - changes in freight rates or change in the average length of haul. For simplicity we have shown no variances in returns and allowances or discounts, so that the variance in net sales is the freight variance. For the moment let's just say that there was an unfavorable variance of $25,000 in mill costs and we'll analyze that in a moment. Thus, we have a $5,000 unfavorable variance in net sales plus a $25,000 unfavorable variance in mill costs to give a $30,000 unfavorable variance in gross profit <u>plus</u> the $70,000 unfavorable grade mix and volume variance for a total variance of $100,000 against our fixed gross profit budget.

Now by selling less than budgeted tons we have not only lost the budgeted gross profit per ton times the loss in tons, but, assuming a cut-back in production, have also adversely affected mill costs. By how much? Let's go back to our mill cost variance report - Exhibit 1. You will remember I pointed out that all but two of these variances were the normal type of price and efficiency variances. The two that are not are rate of operation and volume. Let's consider volume. Let us assume that the M cost per ton at budgeted volume of our Grade A is $10.00. Since we manufacture by order it is not an unwarranted assumption to say that production was cut back in the same amount as sales - 2,000 tons. Now if we cut back our operating time we lose the absorption on 2,000 tons x the $10.00 standard M cost per ton or $20,000, so that $20,000 reflects the loss in gross profit due to the effect of reduced volume on mill cost. The rate of operation variance is a little more technical in detail and I will describe it simply by saying that it evaluates the effect on gross profit of producing more or less than standard tons per hour operated. Those two variances, added to the normal price and efficiency variances, give us our total mill cost of sales variance of $25,000 as we show it in Exhibit 3.

I might just add here that you have probably noticed that I have used mill cost of production and mill cost of sales almost interchangeably. If we valued all inventories at standard I could do that without qualification. We do not value all inventories at standard, however, and with the short time available you will just have to assume that we can reconcile the two and that I am not taking undue liberties with the terms.

Exhibit 4 shows in more conventional report form,substantially the same information as the previous exhibit gave in worksheet form. We see first the original budget, next the adjusted budget based on actual tons sold, then the actual results and finally the variance column. At the slight risk of confusing you I am going to point out one more trick. You will notice across the top that the tons in the orig-

inal budget are 24,000, and the actual tons are 22,000, but under the adjusted budget we have shown 24,000 tons. We have done that because we have not adjusted our budgeted tons, nor the budgeted gross profit, we have simply adjusted the allowance for sales and costs so as to show the effect of volume and grade mix as a separate item and to delete the effect of volume and grade mix from the variances in sales and costs. Also, it allows us mathematically to show a volume variance in tons which is indicative of the volume variance in dollars.

You will notice that we have added selling expense to the presentation in this exhibit. We have done that to point out that our selling expense budget is fixed, and that this is as far as we carry product profitability analysis. We used to carry it down to net profit but, with the possible exception of research expense, felt that our assignment of expenses to products was so arbitrary that the answers were not only questionable but might very easily lead to erroneous decisions. I admit that this is a controversial topic which we don't have time to discuss this morning, but simply point it out as one of the features of our system.

So there we have the picture of one product for one month from which we can trace the fact that it failed to meet its budget by $120,000, back to the things that caused it.

In Exhibit 5 where to conserve space we have expressed amounts in thousands of dollars, we have the total corporate report for all products for the month and year to date carried down to net earnings per share of common stock. All the items below gross profit are fixed, although not necessarily equal, each month. This schedule gives top management an overall look at the results from which they can see whether selling prices, costs, and volume in total are meeting the budget.

I think I can best illustrate what this system does for us by showing you how we can trace all variations back to their inception, because the whole system is predicated on the theory that all variations are expressed in terms of their effect on profit.

Almost any top executive will begin his study of the monthly results by looking first at the bottom of the summary statement of profit and loss where he will find that we earned $.33 per share or $.02 per share less than budgeted. In dollars that is $40,000 but, because earnings were unfavorable, Uncle Sam got $30,000 less than he was supposed to. If those tax relationships look a little askew just put it down to hope. Anyway, we were $70,000 off in earnings before taxes and would have been $120,000 except that we sold some old bonds at a $50,000 profit. So we are looking for the why of $120,000. General expense is right on the budget, but selling expense is $20,000 in the red. We'll see why when we get to the products. Grade mix and volume are off $70,000 and mill costs off $25,000. Again we'll wait till we get to the product for the answers. So our top executive isn't too happy and turns back to the products and to make it easy we'll find our answers on the first product we look at, book paper (Exhibit 4). While our top executive approved the addition of salesmen and increasing advertising because sales were getting harder to get, it is the first time that he can see clearly what it cost - $20,000 per month. The sales manager here might have a little difficulty justifying this in view of the fact that sales volume slipped off 2,000 tons and cost the major share of $70,000. His answer probably is that this additional expense has not yet started to pay off and had he been able to convince certain people sooner the $70,000 would not have happened, but that at least is now on its way to correction.

This then is our system of product-line control. By it we are able to point

out and direct management to those products which are not meeting their profit budget and why they are not. With this system nothing can happen to affect profit without it showing up as an assignable variation, because all variations affect profit. I am sure that it gives Kimberly-Clark top management a sense of security to know that it has an automatic reporting system which will bring out variations due to sales volume reductions as soon as they occur and provide the information to evaluate the effect of expected future volume reductions before they occur. It is also reassuring to know that the evaluations are in terms of profit which is, or should be, the reason that American business is in business.

Exhibit 1

MILL COST VARIANCES
PAPER MILL TOTAL

Mill - N.F. #1 | Year 1952 - 53

Item	Average Var. 1st Q.	August	September	October	November	December
Total Actual	$ 1,580,000	$1,620,000	$1,416,000			
Total Standard	1,575,000	1,604,000	1,391,000			
Total Variance	(5,000)	(16,000)	(25,000)			
Mill Controllable						
Rate of Operation	-	-	100			
Operating Labor	-	-	100			
Maintenance	-	(4,000)	(2,000)			
Raw Material	(2,000)	-	(300)			
Fin. Shrinkage	-	-	100			
Total Mill Controllable	(2,000)	(4,000)	(2,000)			
Staff Controllable						
Labor Rate	-	-	(3,000)			
Price of Material	-	-	400			
Monthly Overhead	-	-	(400)			
Volume	(3,000)	(12,000)	(20,000)			
Total Staff Controllable	(3,000)	(12,000)	(23,000)			

Exhibit 2

ORIGINAL BUDGET
MONTH OF SEPTEMBER, 1952
BOOK PAPER

	Budget Tons	Gross Price	Freight	Ret. & Allow.	Discounts	Net Price	Mill Cost	Gross Profit
Grade A	4,000	$ 250.00	$ 12.00	$ .50	$ .48	$ 237.02	$ 205.02	$ 32.00
Grade B	2,000	230.00	12.00	.50	.44	217.06	192.06	25.00
Grade C	1,000	210.00	12.00	.50	.40	197.10	177.10	20.00
Total N.F. Mill	7,000	$1,670,000	$84,000	$3,500	$3,200	$1,579,300	$1,381,100	$198,200
Kimberly Mill	8,000	2,000,000	120,000	6,000	3,760	1,870,240	1,560,400	309,800
Niagara Mill	9,000	2,000,000	108,000	4,500	3,780	1,883,720	1,591,720	292,000
Total Book Paper	24,000	$5,670,000	$312,000	$10,740	$10,740	$5,333,260	$4,533,260	$800,000

Exhibit 3

REVISED BUDGET
MONTH OF SEPTEMBER - 1952
BOOK PAPER

	Actual Tons	Gross Price	Freight	Ret. & Allow.	Discount	Net Price	Mill Cost	Gross Profit
Grade A Grade B Grade C	1,600 1,800 1,600	$ 250.00 230.00 210.00	$ 12.00 12.00 12.00	$ .50 .50 .50	$ .48 .44 .40	$ 237.02 217.06 197.10	$ 205.02 192.06 177.10	$ 32.00 25.00 20.00
	5,000	$1,150,000	$ 60,000	$2,500	$2,200	$1,085,300	$ 957,100	$128,200
Kimberly Mill	8,000	2,000,000	120,000	6,000	3,760	1,870,240	1,560,440	309,800
Niagara Wis. Mill	9,000	2,000,000	108,000	4,500	3,780	1,883,720	1,591,720	292,000
	22,000	$5,150,000	288,000	13,000	9,740	4,839,260	4,109,260	730,000
Actuals		$5,150,000	$293,000	$13,000	$9,740	$4,834,260	$4,134,260	$700,000
Variance		-	($5,000)	-	-	($5,000)	($25,000)	($30,000)

24,000 ton	Original Fixed Gross Profit Budget	$800,000	
22,000 ton	Budgeted Gross Profit on Actual Tons Sold	730,000	
2,000 ton	Grade Mix and Volume Variance		($ 70,000)
	Total Book Paper Gross Profit Variance		($100,000)

Exhibit 4

COMPARISON OF ACTUAL RESULTS WITH BUDGET
BOOK PAPER TOTAL - SEPTEMBER, 1952

	Original Budget	Adjusted Budget	Actual	Variance
Tons	24,000	24,000	22,000	(2,000)
Gross Sales	$5,670,000	$5,150,000	$5,150,000	-
Freight	312,000	288,000	293,000	(5,000)
Discounts	10,740	9,740	9,740	-
Rets. & Allow.	14,000	13,000	13,000	-
Net Sales	5,333,260	4,839,260	4,834,060	(5,000)
Mill Cost	4,533,260	4,109,260	4,134,060	(25,000)
Grade Mix & Volume		70,000		(70,000)
Gross Mill Profit	800,000	800,000	700,000	(100,000)
Selling Expense	100,000	100,000	120,000	(20,000)
Gross Profit After Selling Exp.	$ 700,000	$ 700,000	$ 580,000	$(120,000)
Gross Profit By Mills:				
Niagara Falls	$ 198,200	$ 198,200	$ 98,200	$(100,000)
Kimberly	309,800	309,800	309,800	-
Niagara, Wisconsin	292,000	292,000	292,000	-
Total	$ 800,000	$ 800,000	$ 700,000	$(100,000)

Exhibit 5

COMPARISON OF ACTUAL RESULTS WITH BUDGET
GRAND TOTAL

M Dollars	Month of September - 1952			Year to Date 1952 - 53		
	Budget	Actual	Variance	Budget	Actual	Variance
Gross Sales	12,000	12,000	-	60,000	60,000	-
Freight	600	605	(5)	3,000	3,015	(15)
Discounts	150	150	-	750	750	-
Rets. & Allow.	20	20	-	100	105	(5)
Net Sales	11,330	11,325	(5)	56,150	56,130	(20)
Mill Cost	9,260	9,285	(25)	45,274	45,330	(56)
Grade Mix & Volume	70	-	(70)	120	-	(120)
Gross Mill Profit	2,140	2,040	(100)	10,996	10,800	(196)
Selling Expense	200	220	(20)	1,000	1,035	(35)
Gross Profit After Selling	1,940	1,820	(120)	9,996	9,765	(231)
General Expense	500	500	-	2,500	2,500	-
Net Operating Profit	1,440	1,320	(120)	7,496	7,265	(231)
Other Income	70	120	50	350	400	50
Gross Income	1,510	1,440	(70)	7,846	7,665	(181)
Other Deductions	20	20	-	100	119	(19)
Net Income Before Taxes	1,490	1,420	(70)	7,746	7,546	(200)
Income Taxes	750	720	30	4,146	4,046	100
Net Income After Taxes	740	700	(40)	3,600	3,500	(100)
Preferred Stock Div.	40	40	-	200	200	-
Net Income on Common	$ 700	$ 660	$ (40)	$ 3,400	$ 3,300	$ (100)
Per Share	$ .35	$ .33	$ (.02)	$ 1.70	$ 1.65	$ (.05)

PROFIT BUDGETING

SUMMARY

Dr. W. D. Knight
University of Wisconsin

At this time it becomes necessary to attempt to summarize the three cases just presented in terms of the value of profit budgeting to management under the special circumstances of a marked decline in the volume of sales and operations. When volume drops, profits drop even more sharply. The question is, what factors cause the drop in profit and what can be done about them.

A part of the answer surely relates to costs. When volume drops, unit costs rise, reducing or eliminating profit margins. In all three cases presented today, variable departmental cost standards are developed as a basis for determining the efficiency variances for which operating management is responsible. In each case, although the details differ, advanced planning and analysis are used to determine which departmental expense should be reduced and by how much it should be reduced for any given drop in volume. This principle of cost standards varying with volume is carried furthest by Snap-on where it is applied to direct costs and to general administrative and sales overhead as well as to manufacturing overhead. Kimberly-Clark occupies a middle ground in this respect applying variable standards to direct as well as indirect manufacturing costs but using a fixed standard for sales and administrative expenses. Allis-Chalmers, because of the nature of its products applies variable budgeting only to manufacturing overhead but in that area has most thoroughly demonstrated its practicability. Clearly cost control is advantageous to management, especially when a drop in sales volume puts a premium on efficiency and on the elimination of waste.

For management purposes, however, it is not enough to know that operations are reasonably efficient if they are not also reasonably profitable. The essence of profit budgeting is an acceptable plan of operations involving the coordination of management decisions relating to price and product policies, sales promotion and production methods. This problem becomes particularly important in the case of companies like Kimberly-Clark and Allis-Chalmers with distinct product lines for which different product managers are responsible. In such cases it becomes necessary to prepare separate budgets and operating reports for each product line. Product-line budgeting is carried farthest by Kimberly-Clark where the separate product-line reports are further broken down to show separately the effects upon profits of changes from the budgeted plan in prices, costs, volume and grade mix. Snap-on, with its homogeneous product-line, does not need and does not have separate product-line budgets.

With respect both to cost control and to product-line control all three budget systems provide standards of acceptable performance as a basis for revealing areas requiring management attention. For cost control the standard provided is variable, indicating at least in outline a suitable plan of action for any level of operations. The action or remedy indicated is usually relatively simple and within the limits of a single department. For product-line control, even in the Kimberly-Clark case, only one fixed standard of acceptable performance is provided; the remedies required when this standard is not attained may involve extremely broad and fundamental management policies relating to marketing, production, engineering, and even finance.

The advance provision of alternative plans of operation is not practical; budget revisions and profit forecasts may be used to supplement the fixed budget, but the most significant contribution budgeting can make is probably the provision of the method and some of the data for the analysis of alternative coordinated plans of management action. It is here that the so-called library function of management comes into play.

In summary then we have three broad, tentative conclusions, of which the last two are somewhat paradoxical:

(1) The three cases clearly demonstrate the adaptability of budgeting to fit a particular company.

(2) Variable cost control can be a realistic and practical tool for the maintenance of operating efficiency. Advanced planning by operating managers over a broad range of volumes has been shown to be practical. Its usefulness is clear.

(3) The broader aspects of profit budgeting relating to basic policy decisions on product lines and how to make and sell them still require a fixed budget, one single coordinated plan of action, one fixed standard of performance. Advanced planning at the policy level for a broad range of volumes has not yet been proved practical, at least not in the form of a written budget. The best we can offer are budget versions and the tools for making special studies.

Here lies the final paradox of profit budgeting. It has been most fully developed and its value has been most fully demonstrated in the area of cost control. It has been less fully developed and its value less convincingly demonstrated in the area of major product and policy decisions. Yet it is here that it is most important to bring to bear the rich library of accounting and statistical information, analyzed and coordinated, which constitutes the master profit and loss budget.

TOOLS OF THE BUDGET MAN

INTRODUCTION

The second half of this morning's program permits us to see the effective use of the tools available to the budget organization when it is charged with the responsi- for offsetting a profit squeeze. The real test of planning and budgeting comes when it is used as the practical means for reversing a rising trend of cost and expense to protect profit margins when selling prices cannot be increased.

Our second panel presents case histories wherein this type of problem was solved successfully. This is not theory, but experience.

The first speaker will be Mr. Edward G. McFadyen, Manager of the Budget Procedures Section of the United States Rubber Company. Ed is one of the charter members of the New York Chapter; and in addition to teaching applied budgeting at New York University, is currently working on a new budget textbook. After his general discussion of the subject, illustrated by experience in U. S. Rubber, case studies will be presented by budget executives of American Viscose and Bridgeport Brass.

CASE STUDY "A"

Edward G. McFadyen
United States Rubber Company

One of the problem areas in the matter of the tools with which the budget man has to work is the accounting and statistical data available to him. Now, the need for complete and adequate facts concerning the operation of the business as reflected in the accounting and statistical records of a company is fundamental and common to all budget men. These records are important because first they tell us where we have been, which is very necessary if we want to have some idea of where we can possibly go. Second, because of the necessity for comparing actual results with planned results, the form and substance of the accounting records will largely dictate the form and substance in which the planned results are expressed. And third, their completeness and their accuracy, of course, will have a material bearing on the significance of the comparison between actual results and planned results as we make them through the year.

It seems to me that accounting has gone through a sort of evolution. In the beginning, we had what you might term general accounting. It had rather an elementary purpose which was to record accurately and adequately the transactions entered into by the business during the period and their portrayal in such a manner as to permit management to discharge its obligations to the stockholders, to various regulatory agencies, and of course, to the tax man. But as business became more complex and more diversified with multi-products and multi-plants, more and more demands were placed upon accounting by management. These demands were usually for more sales information, more cost information, and profit information by product lines and by outlets. From such demands evolved our modern factory cost accounting methods, and also

the use of machines to record such data more accurately and more quickly. This evolution, or this phase of it, took place largely between World War I and World War II when we shifted over from an emphasis on general accounting to an emphasis on cost accounting. The period gave us standard costs, burden distribution, and variable budgets.

The evolution is continuing. It seems to me, as it is going on today, it involves largely the presentation to management of new types of information which management needs by reason of the continuing tendency toward greater diversification of products, changes in volume, changes in product lines and the mix of those lines and, of course, the mix of profits which results from those changes. There is a demand on the part of management for a greater functional breakdown of our costs and expenses, not at the department level but at the product line level. Management wants a better idea of what costs are fixed and the various categories in which they are fixed, and more information on those costs which are directly variable. They want to know the amount of money which must be spent in connection with a particular operation, the out-of-pocket or cash cost as we sometimes refer to it. This greater functional breakdown of cost is not limited to the factory organization, but is found in the selling and administrative group in companies that maintain large selling organizations.

It seems to me we must apply sound cost principles to the area of distribution costs so we may have proper functional segregation first as between the fixed and variable elements and then as to the specific activity in the selling and administrative group which creates the expense. Also, within those same groups we must apply variable cost principles to such activities as warehousing and shipping, billing and the like.

In the United States Rubber Company, we have eight operation divisions, the managers of which are responsible for sales, production, costs, development and the comlete operation of their investments. They budget themselves, and we operate largely on a staff level. We advise the divisions concerning matters of common interest such as the rubber prices to be used, and their share of common selling and administrative expenses. We are the vehicle by which company policy is transmitted from the top down. We consolidate departmental forecasts and budgets into divisional forecasts and budgets, and the divisional forecasts and budgets into the company forecasts and budgets. We transmit these budgets to top management along with appropriate comments and comparisons with recent results. We do the same in respect to continuous cash budgeting. We also perform special analyses of cash and operating functions that may be required from time to time by management and, although that may be the last item on the list of responsibilities, frequently it occupies most of our time.

Now, to do this job we found that we can't live in a vacuum. We can't live in a little office and send out letters and get information back. As a result, over a period of years we have assimilated in the Budget and Forecast Department, which reports to an assistant treasurer, a number of other functions which have aided us immeasurably in doing the entire job assigned to us. Within the department there is a line group to prepare consolidations and to perform similar "production" responsibilities. We have a staff group to interpret actual results and proposed results as reflected in forecasts and budgets. And we have a procedures group whose job is to keep the budget constantly current; to keep it dynamic.

Then we have those collateral or concurrent functions which to some extent in the very beginning came into the department by reasons of convenience, but which have

made some valuable contributions to the over-all budget and forecast functions.

First, we have a staff sales and production coordination section, which has custody of all past sales and production and inventory statistics, and maintains all forward plans throughout the year. Now, the identification of units with dollars, of course, is a very desirable goal, and we have found that we have been able to do a much better job by reason of the fact that we have all of our forward unit production and sales plans in the department.

Secondly, we have a Commercial Research Section whose job is to maintain broad statistics in both units and dollars, showing product line and company performance in relation to the industry and in relation to the national economy. This department prepares special studies for the various divisions on both a departmental and a product line basis.

Thirdly, we maintain the company's accounting manual, and are in a position to influence the adoption of accounting policies which will make the budget serve management better, because we find that it is to us that management directs most of its questions concerning finance and operation. We are the only section in the Finance Department that does not perform some kind of an accounting function. Our job is really to make the accounting figures talk for management's purposes. Therefore, we are in a position to determine what management needs and in many ways to influence how management gets that information from the statistical and from the accounting records.

We also have the audit function within the department. This is strictly a matter of convenience and has not yet been used, as far as I can determine, for any direct budgetary benefit. However, these changes have all taken place in the last two to five years.

In some areas considerable progress has been made, but major accounting changes take place slowly, particularly in a company as large as ours which operates some 40 plants with annual sales of almost $850 million. However, the point that I want to make is that changes are in process. We realize that most of the accounting and cost procedures developed by our company were introduced prior to World War II and that they may not be as adequate today as they were then. Therefore, we are constantly looking at our accounting and statistical procedures to determine where and how and when they should be changed for the benefit of both operating management and top management. I would suggest that in each of our own organizations the budget function not overlook the importance of suggesting and recommending to management needed changes in the accounting system. It seems desirable for the Budget Department to take on, wherever possible, collateral functions which have a particular bearing on the budget function so that we don't maintain a static organization and a static accounting system which may have been fine 20 years ago but which may have become out-of-date. However, it's a problem that each of us has in different degrees and in varying respects depending upon the extent of our operations, the mix of our product lines and the particular profit problems that face management.

TOOLS OF THE BUDGET MAN

CASE STUDY "B"

H. P. Kelley
American Viscose Corporation

Budgeting is frequently referred to as a tool of management. When we hear the word tool, we try to visualize the kind of tool, how it is used and what it accomplishes. Budgeting is a tool that may be used in many different ways but when all of its uses are brought into focus, the principal purpose or goal is revealed and that purpose is the achievement of a maximum profit.

The American Viscose Corporation has been using a budget plan of operation as a management tool for the past several years and it may be of interest to review how this very important aid to management came into use, how it has been developed and how one phase of budgeting has served its objective of increasing profits by decreasing manufacturing costs.

First, a brief description of the American Viscose Corporation. This corporation was the first to engage in the manufacture of rayon in the United States and it is now the world's largest manufacturer of this product. The corporation also manufactures cellophane, self-sealing cellulose bands for bottles, meat casings, plastic moulding compounds, covered elastic yarn, textile finishes and several other products. It operates eight plants with approximately 22,000 employees and the normal annual sales volume is about $275,000,000. It is a chemical industry which includes textile operations and the large capital expenditures required focus attention on adequate return on investment.

Several years ago, a rather crude estimate was prepared annually and this was called a budget. It was then our practice in October of each year to assign a team of three or four accountants to the job of estimating sales for the following year; each plant was visited, costs were estimated and the final result was a statement of expected profits. We refer to this to-day as our "horse-back budget era". No attempt was made to account for or investigate reasons for variances from the budget. It was, therefore, not a management tool. Except for estimating profits, it had very limited use.

Early in 1944, the following situation existed:

(1) Prices of raw materials were increasing rapidly

(2) Wages were also increasing at a rate not previously experienced

(3) Selling prices of finished product were practically static

(4) An investigation revealed that large capital expenditures had been made to improve processes and reduce manufacturing costs and all of the savings resulting therefrom had been used for increased wages so that there was no return to the stockholder for the added outlay of capital.

It was obvious that steps must be taken to hold the line against further in-

creases in cost. With this objective in mind, the present budgeting procedure was established.

Fixed, semi-fixed and variable budgets

Our plants now operate under a flexible manufacturing cost budget which includes direct labor, raw materials and all overhead expenses. Costs are classified as fixed, semi-fixed and variable and for control purposes, budgets are related to production. The budget for each element of variable cost is based upon a production factor. For example, the labor hours for unloading certain chemicals are based upon the tons unloaded and the pounds of each chemical used are based upon the number of units produced. In other instances, the budget for certain labor costs is fixed while for other labor classifications the budget is semi-variable and is based upon a table, that is, there are budgeted labor hours for various ranges of production. Therefore, there is a manufacturing cost budget for control purposes for every level of production and every type of product. It should also be explained that budget factors are selected so that causes contributing to budget variances are easily determined. For example, the variance between the budgeted and actual cost of coal for steam generation may be segregated into the following factors:

(1) The amount due to purchase price

(2) The amount due to the quality or heating value of the coal

(3) The amount due to operation of the boilers as indicated by boiler efficiences.

In this manner, the budget serves its purpose by placing responsibility for differences between budgeted and actual costs.

In addition to our manufacturing cost budget for control purposes, we have a complete operating budget of sales, costs and profits, which we choose to call our forecast in order to distinguish it from our flexible manufacturing cost budget.

The forecast is based upon a sales and production budget. Manufacturing costs are related to the budgeted production on the basis of the factors used in the flexible manufacturing cost budget, and inventory changes are budgeted, in order to obtain a budget or forecast of profits.

The basis for budgets

Budgets of manufacturing costs are usually based upon past experience in order to establish a bench mark from which to measure either progress or retrogression. It makes the selling job easier when budgets are based upon past experience. Also, if costs exceed the budget it can always be pointed out that the budget is possible of attainment since it was attained at some period in the past.

In the setting of budgets, each expense is reviewed with the department foreman or supervisor and costs of immediate past periods are discussed. An agreement between the Budget Department and the foreman is finally reached and the budget is therefore a collaborative effort. A form entitled "Factory Expense Budget Sheet" showing all pertinent data is prepared for each budgeted cost item and this form is signed by the foreman and the Budget Department Supervisor to indicate their joint approval.

Budget Department psychology and foreman attitude

The attitude of the Budget Department representative in this work is very important. It is an attitude of helpfulness and assistance to the department foreman in operating his department. Pride of accomplishment appeals to all individuals and an attempt is made to instill in each foreman a feeling of proprietorship in respect to the operation of his department. The budget is therefore a tool provided to enable the foreman to operate his department most economically.

Department supervisors and foremen in our corporation have shown great interest in their budgets and use them constantly to operate effectively. Flexible budgets are of particular value when production is curtailed since there is a reluctance to reduce costs promptly and to the proper level at such times. During periods of curtailment, there have been many instances when our foremen have asked the Budget Department for data regarding the proper amount of expenses for sub-normal levels of production.

Budget reports

We furnish weekly budget reports for labor only to each foreman. These reports show budgeted and actual hours and amounts for each labor classification and variances in hours and amounts. These reports are used to detect quickly any labor costs that are getting out of line.

Monthly budget reports which include all manufacturing costs are submitted to each foreman. These reports show actual and budgeted amounts and variances for the current month and for the year to date. There are monthly reports showing the budgeted and actual waste product in each department, and there is a report which shows budgeted and actual sales dollars lost due to off-grade quality.

Everyone realizes that reports are of no value and serve no useful purpose unless they are used constructively. A follow-up of significant budget variances is a requisite for any budgeting procedure. In our corporation, it is necessary for a foreman to make the following report on significant unfavorable budget variances:

(1) The reason for the variance

(2) The steps which will be taken to bring costs back into line

(3) The approximate period of time that will be required for the corrective action

The Budget Department follows up on these reports and if abnormal costs are not reduced to the budgeted amount within a reasonable period of time, the matter is brought to the attention of the Plant Manager who may assign the subject to the Industrial Engineering Department for investigation.

The Budget Department at each plant prepares a monthly narrative report setting forth the reasons for major budget variances. Copies of this report are forwarded to the Plant Manager and to the Budget Director.

Since several plants of the American Viscose Corporation have the same processes and manufacture the same products, budget comparisons between plants are of considerable value. These comparisons sometimes draw attention to the fact that one plant is using a superior method which can be adopted at the other plants with worth-while cost savings.

Budget revisions

Manufacturing cost budgets for control purposes are not changed at stated periods but are revised whenever there are changes in manufacturing methods, changes in the wage rate scale, changes in raw material prices, major changes in production schedules or other changes that are significant. It should be made clear that these budgets are not changed except for logical reasons and they are not revised because of failure to meet budgets due to inefficiency.

Budget changes resulting from methods changes are not made until the new method has been installed and experience indicates that the savings are factual. When a budget is changed, a revised "Factory Expense Budget Sheet" is prepared, and the reason for the budget revision is indicated on this form.

Revisions of budgets are posted to a record entitled "Diary of Budget Changes" and there are separate sheets in the diary for each department in a plant. Pertinent data on this form includes the effective date of the change, a full description of the change and the reason therefor, the total annual cost prior to the change, the total annual cost after the change and the annual amount of the increase or decrease in cost.

Reference to the diary of budget changes may be made at any time in order to reveal all changes that have taken place in any department during any particular period. It provides a convenient way of analyzing the reasons for trends in costs.

Budget revisions are summarized by principal reasons for revision in accordance with the following general classification:

(1) Product selling prices

(2) Production schedule changes

(3) Purchase prices of raw materials and services

(4) Wage and salary rates

(5) Methods and efficiency

(6) Quality improvement

(7) Miscellaneous

When there are changes which affect the volume of production or the mix of products, the annual effect on sales, costs and gross manufacturing profit is computed and these figures are entered in the diary of budget changes.

From the diary of budget changes, the Budget Department at each of our plants prepares a monthly narrative report explaining for each department all budget revisions made during the month and this report indicates the annual amount of the increase or decrease for each budget change.

A copy of the monthly report of budget changes is forwarded by each plant to the General Office of the Corporation, where a consolidated report by plants and by classified reasons is prepared. The consolidated report shows the annual effect on costs

and profits of all changes that have taken place at the plants during the month and it also shows year-to-date figures. The report is used by the Treasurer to advise our Board of Directors regarding major changes that have taken place in the plants during the month and the annual effect of such changes on sales, costs and profits. This report augments other comparative reports of budgeted and actual results and its purpose is to provide information regarding the effect of changes in operations well in advance of statistics provided by accounting reports.

The cost reduction program

The flexible manufacturing cost budget plan and the procedure for budget revisions has provided the motivating force leading to the development of a well organized program for cost reduction. The cost reduction program was adopted about two years ago by our Manufacturing Division and it is organized and functions in the following manner:

In each manufacturing department in our plants there is a Cost Analysis Committee consisting of the department supervisor, an industrial engineer, a member of the Budget Department and a member of the Plant Engineering Department. It is the responsibility of each department supervisor to compile a list of cost reduction projects covering activities under his jurisdiction and the other members of the committee assist the department supervisor in originating, evaluating, following through and reporting on the progress of such projects. The members of the committee, other than the department supervisor, may serve on the committee of more than one department.

There is a Cost Reduction Committee in each plant consisting of the Plant Manager and certain members of his staff and the Plant Budget Supervisor. The Cost Reduction Committee meets monthly with each department supervisor in order to consider new projects presented for approval and also to review the progress of projects in process.

Before presentation of a new project to the Cost Reduction Committee, considerable data must be prepared. This includes such items as a description of the project, computations of savings, whether there will be technologically displaced personnel, changes in requirements of raw materials or supplies, changes in equipment, estimates of cost for engineering work and possible changes in manufacturing specifications and processes.

The Cost Reduction Committee determines from an investigation of the data submitted whether the project is to be included in the program, further investigation is required, or the project is to be amended.

If it is decided to include a project in the cost reduction program, pertinent data regarding the project is recorded on the monthly cost reduction progress report which shows the following:

(1) Department and project number

(2) Description of project

(3) Estimated investment
In addition to the cost of equipment, the estimated investment includes significant amounts of capital that may be necessary to maintain stocks

of raw materials, supplies or repair parts. It also includes the estimated amount of any technological displacement wages that will be incurred.

(4) Estimated and actual starting date and estimated and actual completion date

(5) The source of estimated savings and any increases in sales value that will result

(6) Estimated annual savings

(7) Actual savings for the current month, the year to date and the annual rate of savings. (The annual rate of savings must be in agreement with the amount of the budget revision as shown in the diary of budget changes.)

Savings are not posted to the monthly cost reduction progress report until they have actually been made and corresponding revisions have been made in the budget. Therefore, the actual annual savings on this report must be in agreement with amounts shown on the monthly report of budget revisions.

Since each department supervisor must report monthly to the Cost Reduction Committee regarding new projects and the progress of projects in process, the program keeps each department supervisor constantly alert and ever watchful in his search for opportunities to reduce costs.

Proof of the effectiveness of this program in our corporation is indicated by the fact that new methods were adopted in 1951 which brought about annual savings of several millions of dollars.

During the past several months the textile industry has been in a severe recession and our factory operations have been drastically curtailed, yet our budgeted and actual costs are in line since our manufacturing cost budgets are related to production at all operating levels.

In summarizing, I would like to state that budgets are an effective tool in daily use by all levels of management in our corporation and the cost savings factor described today is only one element of a budget program which covers all activities in our business planning.

TOOLS OF THE BUDGET MAN

CASE STUDY "C"

William F. Lowe
Bridgeport Brass Company

It has become quite evident from the meetings of this Budgeting Society and from the literature of other accounting and management groups that more companies are using budgets today than ever before. Companies that thought budgets could not work in their business are beginning to think otherwise. The field has broadened in the last few years and will undoubtedly expand still further in the years to come. To keep pace with this progress the budget man must constantly be on the alert for new ideas, new methods and new applications of budget thinking for these are the tools of the trade.

At the Bridgeport Brass Company where I am employed we started our budget program in 1947. We operate five plants with over 5,000 employees and last year our sales were over $100,000,000. We make brass and copper sheet, rod, wire and tubes in many shapes and sizes. In our fabricating plant we manufacture a complete line of brass plumbing goods, tire valves and accessories, and Aer-a-sol dispensers; in one plant we have a small foundry. We are the largest independent brass mill, our chief competitors being owned by copper producing companies. We must make a profit to stay in business because we have no parent company to run to if we get in trouble.

A large part of our sales dollar goes for raw material and purchased services. We have no control over the prices of these items but we can and do control the balance of available income which must cover manufacturing cost, selling and administrative expense, and profit.

The nature of an industry will dictate where its major budget efforts should be expended. In our industry manufacturing costs take the lion's share of available income. It is on this phase we have concentrated our budget application, and it has served us well in many ways. We do, however, market some consumer items and there selling, advertising and distribution costs are of major importance.

In starting our program one of the first things we did was to review our accounting for costs to determine if it was consistent with the kind of budgeting we wanted. The principles we followed were:

(1) That no foreman, division head, or superintendent should be held accountable for costs over which he does not exercise full control.

(2) That the men who were to be judged by it were the ones to make up the budget. The foremen or department heads were given all the help and advice the Budget Department could furnish but it was his budget, not ours, for we believed you cannot hold a man responsible for performance under a budget that he had no part in creating.

(3) That the Budget Department supply as much information as possible to the operating people to create the feeling that the budget was not designed as a whip for his boss to hold over his head, but was an important part of an over-all profit project for his division in which

he played a considerable part, and that we needed his help and the knowledge of his department and its operation that he alone could furnish.

(4) That reporting of actual vs. budget should be on a functional basis with variances reported by responsibility with the prorating or distribution of costs to products or plants to come later as an accounting function.

(5) That budgets should be realistic. Some operating people are inclined to a little padding while others are over-ambitious in estimating the savings they will make. The Budget Department must avoid both extremes and in cases of disagreement appeal should be to the next level of supervision of the man setting the budget. We had very little difficulty on this point.

(6) That budget allowances for gas, oil, electricity and supplies used in large quantities should be based on usage and any variations due to price should be segregated and reported as such.

We followed these few principles and today all of our 17 major divisions are operating under budgetary control with consistent accounting and reporting.

Our budget is primarily a profit budget and covers all divisions of the business, that is, sales, production, all costs of manufacture, administrative and selling. Our profit budget is prepared in December for the coming year and is submitted to the Board of Directors for approval. The profit goal is then "fixed" until such time as conditions warrant a change and we will change it as often as good business judgment tells us we should. Each revision of the profit budget is also presented to the Board for approval.

Comparisons of actual and budget are presented to the Board and to top management monthly in two ways:

(1) The actual performance of each plant is compared with the fixed profit budget for the plant, both for the current month and for the year to date, without respect to volume. This comparison indicates whether or not the company is meeting the profit schedule.

(2) On another report each plant is broken down into major divisions and the comparison on this report is between the actual results of each division and the profit budget for that division adjusted to the actual volume for the month. This report tells how good a job was done on what the division actually produced and shipped.

While the profit budget may remain fixed for an indefinite period, our expenditure control budgets are all flexible and budget allowances are determined by the activity of the division during the month.

We employ the long term budget to determine the number of physical units we can normally expect to produce and sell over a long period of time. This figure is one that will keep our Sales Department busy, provide a comfortable production schedule with balanced utilization of our equipment, maintain or improve our position in the industry, and result in a profitable over-all operation. We call it our "normal" vol-

ume level.

We have converted the physical units so determined into standard direct labor dollars which we use as the index to determine activity percentage. The manufacturing budget allowances at this "normal" level are used for determining overhead rates which in turn are used to cost products, cost sales and value inventories.

Our budgets and standard costs are tied into our books of account and variances developed as part of our regular accounting.

Every department head is on a budget and gets a report of his expenses each month. We try to anticipate his questions and have a space on the bottom of the report for remarks. If any particular expense classification seems out of line we analyze it and give what facts we can on the report before it is released. Many times we contact the department head with our findings and get his version of what happened. When plant managers or other top executives review their budget reports and the explanations of major variations are already supplied, they don't waste a lot of time trying to get the answers. Favorable variations are commented on as well as unfavorable. No budget or budget program ever reduced costs or improved performance. Only men can do these things and only good administration can bring them about. Budgets should be designed to help men do the administrative job. If you supply the answer before the question is asked, your reports will be more helpful and will be better accepted.

In our company we have three major groups. The first is the top management group consisting of officers and plant managers. They meet once a month on the day after the Board meeting. All figures are reviewed at this meeting.

The next day the President's Cabinet meets. It is composed of all other major executives of the company. The results for the month are presented to this group by projection on a screen.

The third group is made up of all our foremen and manufacturing supervisors. This group is also shown the operating results and the shipments, costs, variations, and profits of their particular divisions are discussed. Representatives of the Accounting Department and the Budget Department attend these meetings and make explanations or answer questions as they arise. These men are considered part of the management team and it is the opinion of our management that if we keep them well informed they can do a better job.

In our company we have an incentive bonus plan for all production and maintenance supervisors and foremen. Their efficiency is measured by their performance under standard costs and budgets. The 100% efficiency level is not an ideal - it is set at a cost level that is practical and attainable by the efficient and economical operation of a division. We believe this plan has helped to make this important group cost-conscious and has contributed to the increasingly efficient operation of our plants.

In 1949 the brass industry went through a major recession. General business conditions were fair. The F.R.B. index was tapering down moderately but our industry had taken a real set-back. Orders fell off and backlogs disappeared. What was happening to the brass industry? Study of the situation by our own management as well as outside economists revealed that customers'inventories were at a maximum; brass and copper prices were considered too high and customers were sitting it out. The

conclusion reached was that the industry was in an air pocket from which it would undoubtedly recover but the extent of the drop and the time it would take to ride it out were not encouraging. Every week of curtailed operation was contributing to operating losses and hurting our cash position. Something had to be done and a course of action was decided on. A large part of the ground-work was undertaken by the Budget Department.

Break-even charts for all divisions were examined. The charts had been constructed from our budgets which covered all expenses. Reports indicated that a good job was being done on variable costs and that any appreciable savings must come from reduction of fixed costs.

We set out to analyze our fixed costs and decided to segregate them into the three controlling categories:

(1) The real fixed costs which are incurred with the passing of time and are not related to the volume of sales or production. In this category are such costs as depreciation on equipment and buildings, property taxes, insurance, minimum plant protection costs, etc.

(2) The next category are the fixed costs determined by <u>current</u> management policy. Into this category fall all organization salaries, research and development, welfare, bonuses, canteens, hospital, etc.

(3) The last category included those semi-variable costs which are usually considered fixed while operating within certain volume brackets. This group includes receiving and shipping, traffic, cost and payroll, laboratory, and the fixed elements of utility services (gas, oil, electricity, etc.)

The last two categories were subject to cost reduction.

The figures were all accumulated by responsibility. Somewhere in the organization was an officer, division or department head responsible for spending this money. Lists of the personnel in each department were prepared and historical data on other costs were assembled. Every executive and department head was interviewed by management and asked to review his budget and to make some contribution to the job that had to be done by eliminating or reducing all costs not consistent with the reduced volume, without impairing the efficiency of the organization. The Budget Department sat in on these meetings and kept the score. Practically every department agreed to reductions. Budgets were adjusted accordingly. New break-even charts were constructed and indicated that break-even points had been pushed pretty well down the line. The new cost level was one we could live with until the storm blew over. I don't know when our Budget Department justified its existence more than on this occasion.

Other projects were undertaken later to improve profit possibilities, curtail costs or conserve cash. Among these were:

(1) <u>Capital expenditures:</u> Review of program with possible elimination or deferment of some items until conditions changed to warrant the cash outlay.

(2) <u>Inventories:</u> Examination of controls to insure the lowest possible inventories of metal, supplies and spare parts that will enable efficient

operation of our plants. It has been estimated that every $100,000 of excess inventory costs from $8,000 to $10,000 per year for interest on the investment, property taxes, excess handling, storage and warehousing, etc.

(3) Selling prices and gross margins: Point out low or no profit items. Determine if costs can be reduced or prices increased; or the consequences of discontinuing the item. At the same time point out high profit items to see if a better job of selective selling can be done.

(4) Scrapping or replacing of old equipment: Maintenance costs were reviewed to find the pieces of equipment which were costing a lot of money to keep them going, many of which were replaced with new modern machines.

(5) Utilities: Review of consumption and rates. Is it cheaper to run furnaces with gas, oil or electricity? Are the rates in our community comparable with other communities our size?

(6) Transportation costs: What are the economics of trucks vs. railroads? Are we taking full advantage of pool car shipments? How should we handle small loads to and from branches and warehouses?

The Budget Department can make substantial contributions to this type of program from which considerable savings and better controls result. If we have to face a post-armament recession a lot of companies will be forced to do something along these lines if they want to survive.

The budget can be of considerable help, but it must be founded on understanding by the men who work with it. It must be practical and realistic and possible of attainment - for if it is idealistic and cannot be attained, the incentive is soon destroyed. Reporting must be simple, accurate and prompt.

The success of any budget program depends on how well it is put together and whether the tools of the trade have been used to good advantage.

CASE STUDIES IN BUDGETING

GENERAL DISCUSSION

Chairman: Here is a question of general interest - "Approximately how large a budget staff is employed at Allis-Chalmers?"

Mr. Bunge: This is a difficult question to answer, because the assignments given to a budget department vary so much. Before answering, let me say that I heard a speaker from a large Cleveland firm say that he has no budget department, and yet that firm has a well-developed budget function. That firm simply uses people who are called other things and who work in other departments to work on various phases of the budget.

In our immediate staff department at the home office, we have thirteen persons, but you will soon see that that is no indication of just how many persons it takes to run our budgetary control system. At each plant we have a Works Comptroller and he has one man assigned to budget duties. These are not included in the thirteen employees previously mentioned. Manufacturing expense statements include both costs and budgets. The statements are most conveniently prepared on the machines that produce the cost figures and these are located within the Works Comptroller's or Cost Accounting Department. The Budget Department does give them the budgetary formula from which the budget amounts are derived, but the statements themselves are prepared by the Works Comptroller's Department.

Our departmental Profit and Loss Statements are rather complicated because of the inter-relationship of the various cost centers in the shop, the various product lines, and other factors. Information from all of the departments concerned funnels through the Budget Department. It is therefore more convenient for that department to prepare the Profit and Loss Statements.

The Budget Department of course prepares the master budget, but in doing this, we obtain the estimates of others who are skilled in evaluating operations, and, of course, the departments being budgeted. For example, we contact and work with the sales group, the Vice President in charge of Sales in both the General Machinery and the Tractor Divisions, the Commercial Research Department, as well as those whose duty it is to keep their fingers on the geographical and product line segregation of sales. These people assist very materially in preparing the budget, and our Budget Department acts as a staff department in guiding and helping them. Our function is partly to help bridge the gap from the past, which is experience, to the future, which is depicted in the budget. The decisions are made by the management of the various functions; the Budget Department is simply the catalytic agent that puts these factors together and re-presents them.

Chairman: I think that the explanation of Mr. Bunge will answer to a great extent the question as it pertains to Kimberly-Clark, American Viscose, United States Rubber, and the other large corporations represented on our panel. It is difficult to be specific because we believe that the core of budgeting lies in the preparation of budgets by the people who will have to see that the budgets are met, and therefore, a relatively small coordination staff can accomplish the work that is necessary. However, I think we might ask Bill Lowe, of Bridgeport Brass, what the approximate number might be in his type of operation.

Mr. Lowe: We did at one time have 5 or 6 people in our Budget Department and

this group installed budgets in practically all plants. As the manufacturing budgets were given a trial run and perfected, they were turned over to the Cost Department of each plant for administration. There is a man in each plant responsible to the Budget Director for the budget activities in that plant, but only insofar as manufacturing costs are concerned. The balance of the budget is made up in the head office where we have the Budget Director, myself and one girl. We do the profit budgeting and consolidate all the budgets from the various plants -- the job is principally one of coordination and analysis.

Chairman: I believe that will give a representative cross section of the requirements and the allocation of the work -- it comes back to the basic premise that a budget is not a blanket but is tailor-made to fit the needs and requirements of the individual company.

Here is a question which has been handed to me that I hesitate to pose at this point because of our time limitation - "Is it the opinion of the panel that the budget and accounting function should be under the direction of one person -- if not, why not?" It's a very good question and one that in our chapter meetings and in the meetings of not only our Society but other societies as well has been discussed at great length. To save time, I'll undertake to answer this question for the panel.

First, I believe that personality is a prime factor. Second, the volume of work must be considered; and third, the demands and the expectancies of management definitely enter into the problem. Once again you come up to the point -- how much work can one man handle efficiently. In many smaller operations it is quite feasible, and in fact it would be prohibitive from a cost standpoint, to have separate organizations. However, as demands are placed upon the budget function it becomes questionable whether or not one person can do justice to the job as it has presently developed in many corporations. It certainly is impossible for an individual who thinks only in terms of the past to do an adequate job in budgeting and forward planning, but someone who is able to look to the future can supervise the activities of budgeting and accounting at the same time. However, the viewpoint of the company, whether it is placed on the past or the future operation, will determine to a great extent whether or not one individual can do it. This represents a broad attempt to answer a specific question within the permissible time.

From Floor: Direct labor has always been variable without question, but in the case of the guaranteed annual wage it seems to me that a portion of direct labor, or the pay for it, is guaranteed for a year. I wonder if the panel doesn't include someone who has had some experience with the guaranteed annual wage?

Mr. Bunge: We do not have a guaranteed annual wage, but I should like to elaborate a bit on what someone else said before. With us, direct labor is completely and entirely variable. It is true that we do keep employees on the payroll at times when there is a temporary decline in volume within a cost center. If it is possible to transfer those people who will not be needed in that cost center to another one for the duration of the reduced volume, that will be done. If the decline is general and of long duration and they cannot be transferred, then of course there will be a reduction in personnel. If, however, there is a sudden drop in volume which is temporary, the personnel within the cost center may be continued on the payroll, but those who were on direct labor then cease to be direct labor employees. They are given other assignments if possible and they are charged to a Lost Time account. This account is a subdivision of the indirect labor classification and is a part of the burden cost. The cost then stands out as one of the variances and it becomes

one of the penalties we incur for operating under today's conditions.

Consequently, so long as anyone is charged to direct labor, it can be assumed that that person is working at a job directly identifiable with an order number and and as such is chargeable as direct labor. As soon as that situation ceases, the man is either off the payroll or he is charged to a burden account (waiting time, lost production time, etc.).

Some budgetary allowance, based on experience, is made for lost production time. If that expense exceeds the budget, it is a signal that something unusual is happening in that operating area.

From Floor: I wonder if it wouldn't help if we stopped looking at direct labor as 100% variable.

Mr. McFayden: Direct labor is really only 100% variable under ideal operating conditions. There are many factors which will make direct labor other than 100% variable: poor scheduling of production; re-operation costs; high scrap and damage. In our company, every endeavor is made to prevent lowering the production schedule one month and raising it the next because of the problem of dealing with labor. Our profits are not so great that we can keep a bank of extra people on over any length of time - we'd have to lay them off. Therefore, the primary responsibility of production management is to keep a stable labor force. There are other things that will influence direct labor, and in our own company we reflect all those variances: reoperation, waiting time, scrap, etc., as direct labor cost variances rather than burden variances. But I think we sometimes fail to realize that direct labor is not 100% variable, even under normal operating conditions.

From Floor: Do you charge cost of goods with the expense of idle manufacturing facility?

Mr. McGuire: We are going to use the realistic approach to that particular problem. We have a plant which will change operations in the Fall. It is going to run at 50% of capacity for a while, and then it will shut down for a period prior to start-up on the new basis. We have decided that we are going to take that unabsorbed burden out of our mill cost completely, and treat it as a general charge against income.

4 VIEWS OF THE ROAD AHEAD PRESENTED AT LUNCHEON SESSIONS

A NEW LOOK AT BUSINESS

George H. Coppers
President
National Biscuit Company

When I heard that the central theme of your conference was to be "The Road Ahead," I was reminded of a very thoughtful talk I heard a few weeks ago by Arch Booth who is the Executive Vice-President of the Chamber of Commerce of the United States. He chose for his topic, "The Future is Today," and his point was that what we are going to be tomorrow will be determined very largely by what we do today. Of course, he dealt with questions of government and national economy, and he was urging business men to take an interest in the government today or expect a change for the worse tomorrow.

You gentlemen work in a somewhat narrower sphere but the same principles apply. What happens to our businesses in the future is going to be largely determined by what we do today. It seems to me that now is a good time, before we embark on the "road ahead," to look about and see where we've come and how we stand. It may be that we shall wish to make a few adjustments before we proceed on the road ahead.

During your Conference you have heard or will hear from top economists who will tell you, I suppose, what the future is going to be, as they see it. I won't go out on a limb like that -- I will content myself with a very safe prediction and say that things are going to look different tomorrow. I say that is a safe prediction because the history of the world has been a history of change, and just as sure as death and taxes is the fact that things are going to be different tomorrow. It would probably be safe to say that in the days immediately ahead there will be some levelling off of the constantly upward trend of consumption and production and expansion. I think it is probably safe to say that we have been enjoying good business for several years -- ever since we snapped out of the slump of the '30s. The boys who were responsible for sales have lost their lean and hungry look, and the ulcers have taken on a protective coating, and we are probably all sleeping too well. I think that now might be the time to take a look at some of the careless habits that we may have gotten into. I think we should not be like the taxi driver who was driving in his usual reckless fashion when a lady passenger tapped on his window and said, "For goodness sake, every time you go around a corner you scare the daylights out of me." He said, "Lady, relax. Why don't you do what I do when I go around a corner -- shut your eyes."

I think this is the sort of period when a mild flavor of decay may be apparent in some of our businesses. In the human being age is usually accompanied by an inability to adjust ourselves to sudden changes, such as cold air or cold water or cold weather. It is also a period of illusion in which we live in the past and cling to shadows of things that are gone and hesitate to face the future. Now, this age that I am talking of isn't a matter of years. We know of people who are young at 70, and

we know of people who are old at 30. Age is an attitude. I think that our age is measured by our attitude, or our ability, to adapt ourselves to change: if we can adapt ourselves quickly, we are young; if it takes us a long time to adapt ourselves to change, we are old. I think the same thing is true of business. The future of our businesses is going to be determined by their ability to break with customs, traditions, products and practices that are outworn, and adapt themselves to change, without dying in the process. Our business bodies have a very striking advantage over human bodies: A business body can be rejuvenated; it can be brought to life, provided we take the necessary steps before it dies in its sleep.

Now, I don't attempt to qualify as a business doctor. I don't claim to be an expert in geriatrics as it applies to business, but I have been exposed, let us say, to some situations that seem to call for rejuvenation. I've observed some of the symptoms of decay and I've even attempted to apply some remedies. Maybe that qualifies me to look at the picture with you and to look at some of the symptoms. If we look at them objectively, it may be that the cures will suggest themselves.

One of the most annoying symptoms of decay is seen when people in an organization begin to sit tight. It is one of the greatest enemies of change, and it doesn't necessarily come with age of individuals, although it may. It has a number of manifestations. Sometimes when people have gone on for a great many years in their business career -- reasonably successfully or without having made very many mistakes -- as they approach the end, or the period when they will shortly be retired, they think: "Why take a chance on making a mistake now? After all, the matter can wait; let my successors worry about it." This is the "after me -- the deluge" attitude, and it can strangle progress. It sometimes poses a very serious problem and a very difficult problem to deal with, because sometimes when you've found that people have gotten into that attitude you have to put them some place where they can't do any harm even before they reach the age of normal retirement.

The ancient Greeks used to take their problems to the Oracle of Delphi, and when the Oracle was asked a question he answered it in such a manner that you couldn't tell what the prediction was or what advice he was giving you until after the event had occurred. Now in this way the Oracle could never make a mistake. Sometimes in our organization we find people who don't realize that that trick is 5,000 years old. They think that they can straddle questions so that in the light of after events they'll never be proved wrong. If you asked them for an opinion of something, they'd give you all of the arguments on each side and they would leave it up to you to figure out which side they're on. They're on the one hand and then on the other hand. Don't let them get away with it. Pin them down. And if they don't change their tune, tell them they are in the wrong business, that they should be fortune tellers because they are not any good to you, or to me, or to whomever they may be working for.

Sometimes in our organizations we find people who develop an amazing capacity for mind-reading. You ask them what they think about something and they immediately tell you what you think. Well, now, you don't need anybody to tell you what you think. I don't need anybody to tell me what I think -- I know what I think. What I need, and what you need, is for somebody to tell you what he thinks.

Now, I am a firm believer in promotion from the ranks in every case where there is talent in the ranks to fill the particular job that you have to fill, but I am not a fanatic about it. I think that every once in a while there opens up in our organization a good job that calls for talent that hasn't been developed in our ranks, and I think that is a time when a little new blood is helpful. There is such a thing as

becoming ingrown.

A short time ago in our company we were having trouble with a product -- it wasn't doing as well as it should. I was talking to one of our boys about it and he said, "Well, nobody is doing very well with that product today." He said, "The public are getting tired of that." "Well", I said, "for Pete's sake, get somebody in here who doesn't know that." Sometimes you will find that your people become experts on why you can't do something. Well, in a case like that, the thing to do is to get in some youngsters who perhaps don't know that you can't do these things, and you might get them done.

Now I think that loyalty properly understood is one of the major virtues. On the other hand sometimes in our organizations we find people who mistake atrophy for loyalty -- who blindly follow instructions. They find that a convenient substitute for thought, and they also feel that if they follow instructions carefully enough they can't go wrong. They don't attempt to analyze the instructions -- they have some strange notion that if they attempted to analyze or question the instructions, that would be disloyal or at least that is how they rationalize it. These are the light brigade boys. "Theirs not to reason why, theirs but to do and die -- into the Valley of Death rode the 600". Now, before some drone rides my outfit to destruction on account of something he thinks I said, I would rather have him tell me first that he thought I was nuts!

Very close to the light brigade boys and sharing somewhat of the same complex are the people who attempt to go by the book. They can quote you chapter and verse of every instruction that ever went out of the General Office, and as a matter of fact they never travel very far from home base without lugging a brief case full of instructions. And if something new is suggested and they can't find anything about it in the book, they are likely to tell you that it is against company policy. There are people who use company policy like a drunk uses a lamp post -- they use it to lean on, not to see by. This company policy business is one of my pet hates. One time in my company I heard so much about company policy that I sent out a letter, saying: "If you can't find any better reason for not doing something than that it's against company policy, for goodness sake go ahead and do it."

Sometimes responsibility and authority in an outfit begin to get fuzzy and blurred and unclear. Maybe you have a meeting of your top group and you decide on a course of action. Then you disperse and after a while you wait and nothing happens. And so you go out to find out what's the matter. And what you find out is that everybody thought that that particular activity was in the other fellow's sphere. Each one thought the other had the ball. That happens sometimes in an organization when the top authority is divided among too many people of equal rank, and it turns out that everybody's business is nobody's business. We have tried in our company to correct that in that we have five major divisions -- Sales, Production, Procurement, Finance and Personnel. Now there are some minor, smaller autonomous divisions, but generally speaking if anything goes wrong in the organization it is likely to be in one of those five divisions, and there isn't any question about who heads up that division. Now, it wasn't always that way in my company. I remember a time when the head of our Engineering Department was a Vice-President of the company and the man who was in charge of all the company's production was just one of the boys. That might be all right in a company that is in the engineering business, but as you know I am in the food business and that was a perfectly cockeyed arrangement. Now this sort of situation, where the lines of authority become fuzzy and blurred, you don't cure by just getting yourself an organization chart. I know people who have blind

faith in these organization charts -- one of these things where the president sits at the top and the vice-president sits under him and you get down to the fellows who do the work, and as you look down at the thing it's all very clear. You can see how the lines seem to flow down by gravity; but if it isn't just as clear to the guy who is on the bottom looking up, you might as well throw it away.

I had an experience just after I became President of the National Biscuit Company -- a friend of mine who had for some years been president of a successful organization undertook to give me some advice. He said, "George, the first thing you do is to get yourself an organization chart." He said, "I've just completed my organization chart. We've been working on it a long time. It covers a whole wall of my office. I don't know what I'd do without it." And a short time after that a young friend of mine who had been working for this outfit for 10 years quit. And I said, "Why did you quit?" "Well," he said, "I have been working there for a year and I haven't been able to get in to talk to the Vice-President who is in charge of my department." My friend who had the organization chart had the best intentions in the world I am sure, and he couldn't see any road block in his communications on that organization chart. They don't show up on organization charts. Sometimes an organization chart will lull you into a false sense of security. If you look at an organization chart you are likely to think of it in the terms of the law of gravity where everything flows from the top down. As a matter of fact, a business organization, as I see it, is like a plant -- the circulation, the ideas should come from the bottom up. In a plant, if the circulation and the feeding don't come from the bottom up, it is going to wither and die. The same thing is true of an organization. In my mind an organization chart of the successful organization -- if you are going to think of it in terms of the law of gravity -- would present a better picture if you turned the darn thing upside down.

Now, I have suggested that nothing remains static -- the door closes behind us at every step. We can't go back; either we go forward or we die. We can't go back to the good old days -- they weren't so good anyhow. In the past hundred years the world has made more progress than it made from the beginning of time up to a hundred years ago, and the pace, the tempo, is increasing all the time. We not only have to move forward all the time but we have to move forward pretty fast, or we get caught in the door.

In the past hundred years science has made tremendous progress in increasing the life expectancy of people, and in that same time it has made equal progress in decreasing the life expectancy of things. Our products become obsolete quickly today. I am in the food business and I know that the products on the grocer's shelves are going to be different tomorrow. My job is to see that our products are on the grocer's shelves tomorrow. If we are going to be in the picture tomorrow we have to be figuring out today what we are going to be doing tomorrow. That is why I believe that research is one of the fastest growing departments in any successful organization today. Somebody said that research is the job of figuring out today what you are going to be making tomorrow. Dr. Kettering said that research is a high-hat word that scares a lot of people but it shouldn't. It's only an attitude. It's a friendly, welcoming attitude toward change. It's a going out and looking for change instead of waiting for it to happen. It's a tomorrow rather than a yesterday type of mind. Now all this suggests that there isn't going to be any room on the road ahead for slow, top-heavy organizations. The pace is getting faster and faster and like Alice in "Through the Looking Glass," we are going to have to run faster and faster if only to stay in the same place.

I've suggested some of the signs of decay that slowly creep into organization.

It's too bad for us humans that when decay sets into the human body there is not much we can do about it, but in our business bodies we are somewhat more fortunate. They can be rejuvenated provided we see the necessity fast enough, and have the courage to make necessary changes. Now, the time to make the necessary changes is not after we get on the road ahead because that's too late. I say it's too late because decisions made under the guns are usually bad decisions. The time to get ready for this road ahead is today before we come to the turn, and that's where you budget men come into the picture. Now is your time to get into the act. We've said things are going to be different tomorrow. We've said that probably the trend of expansion and production and consumption is going to level off, and as a result of that there'll be some contraction. There'll be some adjustments. Competition will get thick. Which means that we won't be able to afford any activities that aren't paying off, and conversely we won't be able to afford to be without the activities that we need.

Now, I suppose in your organizations as in mine, a number of new divisions, departments and activities have been activated in recent years. I suggest to you that the larger excess profits taxes have made us a little bit careless of expenses in recent years. Now is the time to take a look and make up our minds whether we can afford these activities in normal times. Your job is to plan and anticipate what we need in the future. The time for you to go to work is now because the future is today and the road ahead is here.

MANAGEMENT LOOKS AT THE ROAD AHEAD

Hamilton Merrill
President
Manning, Maxwell & Moore, Inc.

Yesterday and today you have listened to talks by men of top ability on the subjects of economics, techniques of budgeting, and related subjects.

In my informal talk today, "Management Looks at the Road Ahead", I would like to assure you that I speak only as an individual representing a moderate size industrial company. In no way do I undertake to be an oracle, or speak for management in general.

However, in my forty years of operating, I have acquired points of view and certain convictions which I would like to offer to you for what they are worth, and I would like to discuss:

FIRST, what management can do with your help to direct its own destiny, and

SECOND, things which you and management can do to help preserve the Constitutional Rights which have made possible our being here today, and which are vital to the continuation of our well being.

Let me start out by saying that I have the highest regard for budgets and the men who direct them. Your aim in life, demonstrated by your very presence here, is to help control the economy through the medium of budgets and, in so doing, eliminate waste.

There are plenty of reasons why budgets cannot be accurate today, with constantly changing conditions. There are good excuses to cut them out. But, they are needed more than ever. Making a good budget requires the planning ahead which is indispensable for business.

Business is an organized society of human beings. The many types of budgets that you prepare actually provide a yardstick for human endeavor, regardless of how successful that human endeavor may or may not be. But, too often we permit our thinking to become mechanized, whether it be on budgets, statistics, organization charts, or the aberrations of the Administration in Washington.

For instance, the Works Accountant presents figures at the end of a month. These figures show the operating results, the ratio of direct labor and expense, the company's earnings, the changes in inventory, and other pertinent data. Such figures are probably available from ten days to two weeks <u>after</u> the month is ended. By that time, the second month is well on its way, and valuable time has already been lost in relation to correcting the operating weaknesses which may have developed. Therefore, I say, that if the Works Accountant is to provide the best possible analysis to the Works Manager, it is necessary that a weekly, and even a daily, record of the operations be available, so that any weaknesses can be corrected almost immediately. In the same way, the Controller and the Director of the Budget can provide similar assistance in overall company operations.

One of the dangers of figures is that they are sometimes inclined to control us,

rather than our controlling them. They should be used as a tool to mark the road ahead, rather than as excuses or records of past mistakes.

It is common practice to accept figures about what we do in our operations, and then try to explain why we failed, or why we succeeded. We talk of the squeeze between labor demands and frozen selling prices; of government interference; of taxes; of many problems; and we are often inclined to accept the many charts of our economists as immutable laws rather than as tools for management's use.

Recently some economists, speaking before the National Industrial Conference Board, expressed the view that if the government plans for the military program go as scheduled, we shall start, in 1954, to get a 20 billion dollar cut-back in national spending. If that happens, then there will be a 20 billion dollar gap to fill, and the question is raised: "Where will we find a buyer for that 20 billion dollars, to avoid an important recession in business?"

Isn't that somewhat the lazy way: to accept the predictions that demand will lessen next month, or six months from now, or next year, or in 1955...predictions based, to a large extent, on assumptions interpreted as facts?

Let us respect but not worship the economist. Let us remember that nothing is static, whether it be military logistics or the theory of relativity. And, if we fear that there is to be a recession in business, let us use the tools available to create more demand for our products.

There is one fact which I have never seen change, and that is if you make a person want a thing badly enough, and give him the money or the credit with which to buy it, he <u>will</u> buy it! So, our first step, as always, is to find out how to sell better, to sell more, and that means to create more demand and to see to it that the people have either the money or the credit with which to buy.

Any sales manager worth his salt knows that wants can be created by the proper application of proved marketing and merchandising techniques.

In order to provide people with some money or credit so that their purchasing power can be increased, there is one very sound correction that can be applied; that is, less taxes! "But", you say, "how can taxes be reduced?"

Well, how do you reduce expenses in your business? There comes a time when forthright action has to be taken to save a business in spite of all the reasons why you can't. This must be applied to government expenditures. They can and must be brought down, but Congress must feel that the people want IT more than expenditures.

I am sure that if any of you, trained in business efficiency and effectiveness as you are, was to spend two or three days in Washington, going through the various bureaus, getting acquainted with how they work, and seeing men of real ability sitting around with little to do because their jobs were poorly conceived, you would be more decisive about writing or talking to your Congressman, and getting other people to write or talk to theirs about the tax situation.

In the road ahead for American business, there will probably be new valleys and new peaks. But, I am convinced that the basic curve of production and consumption will be continuously upward, as it has been throughout our history. One way that we can level some of the dips and peaks is by the proper control of inventory -- very

much a part of the responsibility of many of you.

Usually, when business is good, inventories are increased because materials are hard to get, and everyone is buying. The result is that we come to the end of a buying spree with a top-heavy inventory, which we soon find we must reduce. One of the obvious results is a buying vacation, with a resultant drop in business and consequent unemployment. Obviously, inventory control is an important factor in business trends.

More than ever, research and development are indispensable to the future progress of our economy. Responsible for the tremendous strides which have taken place over recent years, development and research hold the key, I believe, to progress on the road ahead, undreamed of a few short years ago. We have only to look at such industries as plastics, man-made fibers, aluminum and atomic energy. It is new developments such as these, often made at times when our economists and professors told us that we had reached our full economic growth, that have made possible the continued improvement in our way of life.

Another important marker on the management road is our attitude toward today's federal government. There are those who say that people have become too dependent on government; that government is in the saddle and running our economy and, however much we may want to, there is nothing we can do about it. That is the nice, easy, comfortable way that is usually taken by those who, when they get home at night, say to themselves: "Well, I was ready to do something about it -- but it just couldn't be done!"

The unfortunate part about such defeatism is that never in the history of our country have such alibis for lack of success been so acceptable. But here and there we see companies that are making progress in spite of government interference, price ceilings, high taxes, increasing labor costs. And I believe that if we analyze the reasons for the success, a substantial part of that reason will be their approach and their unwillingness to accept the easy solution: "It can't be done". These companies usually have a simple 3-point fundamental approach:

(1) They develop a plan of action,

(2) They put it into execution, and

(3) They climb over, under, or around any roadblocks in their way.

With the philosophy of "It is going to be done," with the spirit to see it through, any company is in a position to accept the challenge imposed on it by governmental administrative policies, labor demands and constantly changing world problems.

About the only sure way to go down to defeat is simply to resist anything that the Federal government is trying to do. The men in Congress, and the men in the Administration, are human beings like ourselves. If they feel that you are completely biased, have a closed mind, you are not going to get very far.

If, however, you can present your case, equipped with facts and figures and a constructive program, your chances of success are several times better. It has been my experience, speaking in several labor-management forums, that we in industry have these facts and figures in our favor IF we will take the trouble to dig them out and present them in a logical, plausible manner. Every person in this room is an impor-

tant figure in his community. You have it in your power to help educate your community leaders in the values of the free enterprise system, the problems of business, and the way in which human liberty is slowly being destroyed in our present approach to Socialism.

If you -- each one of you -- were to talk to your minister, to your high school principal, to the natural leaders of your community (men <u>and</u> women), and explain to them some of the facts which you understand so clearly, you could become the nucleus of a great power for good.

This is not something that can be taken lightly and discussed with some friends who agree as you do, and then be dropped. It is something to which, in your own personal interest, you should be willing to devote a number of hours each month, telling people in your community about the facts in which you believe.

Recently, a group of 30 school principals visisted our plant. We had a program whereby our operations were shown and explained to them, and then each of our department heads gave them a brief talk on his part in our economic operation. Many of them commented on the things they had learned about business that they had never know before; how they had not realized that dividends today were worth less in purchasing power than the dividends of 10 years ago, while wages had gone up 100 or more per cent.

The duPont Company, at great expense, prepared a method of explaining the problems of operating a business in the system called, "Visual Economics". It is a simpresentation which can be given to presidents or the man on the machine. It is short. It takes one to three hours to present. The president of one of our universities said it was the most effective method of presentation of a subject that he had yet seen. How helpful it would be if your company were to arrange so that certain people in your community could see this demonstration. It all helps to tell about the importance of free enterprise and how management, labor and capital are all interdependent.

How many of you have taken the time to write your Congressman fully on taxes? How many of you have promised yourselves to do something about it tomorrow, or next week, or next month?

Ladies and Gentlemen, what I propose is NOT new, but it is too often overlooked. We may have to give up a few hours of pleasure, but it is the kind of organized effort that will pay off. It is the kind of organized effort which elected Taft in Ohio when the odds were against him; and elected Bennet in Utah, even though he had been President of NAM and was, therefore, considered vulnerable.

If we were all members of a labor union, policies would be determined at the top and our district leaders would have their orders which they would enforce, and a united front and policy would be presented. This to a large extent, is true in politics.

Businessmen, on the other hand, owe their success to their initiative and individualism and for that reason, business cannot be regimented to present a united front such as faces business today. In addition to this, the very laws of our land make it difficult for us to unite effectively in meeting the threat to the American way of life. In other words, our politically minded labor leaders and our labor minded politicians are using the policy of "Divide and Conquer" to lead this country into socialism -- or worse. But, I have faith that the qualities which have made America

great, and the intelligence of you leaders of business, will enable us to cooperate and make some personal sacrifices to attain our common goal.

We must learn to depend more on ourselves and not sit back and wait for someone else to solve the problems which face us.

If we go back to the colonial days, we will recall that each man kept a loaded musket in his house ready to defend his family and his home. This was equally true with the Minute Men of Concord and Lexington. Our forefathers came here from Europe to escape the tyranny of government, that all-devouring monster which is facing us today. Men, such as Patrick Henry, were ready to risk their lives, when they said, "Give me liberty or give me Death."

Do we care so little for our children, let alone ourselves, that we are willing to sit supinely by and see this nation of ours destroyed?

I, for one, have a great and abiding faith in the strength and virility of American Industry. If we look back over the past 20 years and see the laws and restrictions that have been placed on business, we find it has been retarded in spots, divided in others, but on the whole it is strong and more successful today than ever before. And this did not just happen! It was due to the courage, the imagination, the initiative of the leaders of industry, and their willingness to meet challenge and defy defeat.

<u>If you believe</u> that the United States is still the best place to live; <u>if you believe</u> that our forefathers made a contribution to our welfare when they created this great country of ours with its freedom and Constitution; <u>if you believe</u> you should protect your children from a Socialist or Communist state, then:

THINK about this problem,

TALK about this problem,

DO SOMETHING about this problem!

FRONTIERS OF MANAGEMENT

Dr. Peter F. Drucker
Author and Consultant

I think it's very appropriate for this gathering to talk about the frontiers of management, because I am convinced that in the 10 or 15 years ahead the major frontier of management will be in your area - in the area of controls, tools and instruments for charting management's course. You are, so to speak, the beachhead on this new continent which I think we are going to explore and conquer within our life time. It's still, as I think most of you realize, an unexplored continent by and large.

A friend of mine, who is in the management of a very large company which is widely esteemed for its controls, has an expression that top management, including his own, reminds him of a six-engine jet plane flying across the Atlantic at 60,000 feet by the seat of the pilot's pants. And I think that perhaps is very largely true. I would say, to vary the illustration, that this area of controls reminds me very much of the way they used to draw unexplored areas on old maps. You know, they didn't just leave it white and say unexplored; they put in some imaginative creatures such as unicorns, or even creatures with two heads. I would say that you could define this area of controls as a big white space on our management map, with an inscription: "Here accountants roam".

I don't have much more against accountants than Mr. Merrill has against economists. Some of my best friends are accountants, and I have very great respect and admiration for them. I consider a profit and loss statement one of the better works of fiction, and when it comes to depreciation I bow to them as a magician definitely outclassed. But I don't think that they can and will contribute to the need we have for controls for the very reason which has made them, I think, deficient in their contribution to people in management. The accountant today is, through no fault of his own, not working for the business, but for Uncle Sam. The importance of taxes, for instance, has meant in most companies, that the most competent men in the finance and accounting-control area are working on tax matters which are extremely important but which don't help management run the business. And I think the accountant will continue to be preoccupied with furnishing tools for external uses; for the Internal Revenue Department, for the bank, or the FTC, and for a host of other outside uses; rather than with furnishing tools for management's own use. I don't think that is a criticism of the profession. It may be a criticism of the world we live in, but these things are so important to every business that quite inevitably the accounting people are pushed in that direction, increasingly. So, I think the job of patterning the tools for control will have to be done not by the accountants, though obviously a great many people with accounting background will be needed, but by people who will start out with the question of what tools does management need; not, what tools does the tax lawyer need.

What tools does management need to run its business? What tools does it need to operate by judgment rather than by the seat of its pants? What tools does it need to be able to see, to make a decision and change course before it has run into the mountain ahead? (I don't have to tell you that instruments aren't much good if they register the collision after it has happened.)

I think the need for these tools is today the predominant need of business management and will become more and more pressing. I don't like to predict any more

than I have to, and if I have to predict I always like to do it for 50 years rather than for six months, for reasons that every man in this room knows. But I don't think you have to be very much of a seer to look at some of the things which are ahead over the next ten years; and every one of them calls for workable controls, for a workable instrument panel for management. Let me mention just a few.

The time span of management decisions has been lengthening very rapidly. I've noticed that in my own consulting practice, comparing the time span for which my clients and I make decisions on capital investments, on a distributive organization and so on. Even 10 or 12 years ago it was much shorter. Today we make decisions for 10, 15, or 20 years ahead. Let me say that no financial or economic controls can do the job, if that is the case. If we have to make management decisions for such a time span as this, we have to make sure that the people will be there tomorrow who will bail out the decision, because nobody can predict 10 years ahead. Just cast your minds back and see what a prediction would have looked like in 1927 on a 10 year basis, or in 1937. No matter how able the economist or how gifted the businessman, you can't predict life, in today's world, for that long a time. So, the provision of the management people who will have to bear out the decision is as integral a part of the decision as the decision itself. And executive development and replacement is in itself a major control and one of the things which anybody concerned with controls should consider. It is the part of the controls machinery that makes all the others valid. So, even though this problem of the lengthening time span is not entirely a problem of our kind of control, it can't be handled without the kind of controls we are primarily interested in here today.

Then take the trend toward decentralization of industry. This is a very misleading term because it obscures the fact that you cannot decentralize without very much better controls of performance, very much better controls of objectives, than most businesses have ever heard of. Decentralization means that you set up a unit autonomously in such a manner that it operates against standards, objectives, and goals rather than against supervision. The major problem is a control problem which very few businesses either understand or have the controls for. Many who go ahead and decentralize are going to rue the day. Yet, I believe it is a desirable trend.

I am almost certain that within the next ten years we will be faced in a serious manner with the problem of the predictable, guaranteed wage. I am very unhappy about this for the simple reason that the predictable wage should come as the end result of a control system and not as the occasion for it. But it will come whether I am happy about it or not; and the moment we have it, we have tremendous need for controls that will enable us to predict, especially as we are going to have fairly heavy stakes in it.

Another influence is the very rapid acceleration of technological change. Frankly, I am worried about the fact that so few businesses tackle the problem of forecasting the rate, the direction and the speed of technological change. It can be done. It is not easy, but it can be done within margins of error which are not quite as wide as the barn door, 10, 20 maybe 25% either way. That's a narrow margin for that kind of analysis. I think it is essential for practically every business I know, because we no longer operate in an economy in which the major competition comes from people turning out the same product, just a little cheaper. The major competition comes from people turning out a different product, a different way. If you have that situation you need an understanding of technological developments, a realization of what makes for major technological changes, what makes for minor ones, what are the trends that actually relate to the business, what are the things that have to be done

to stay in the race. It can be done. It is being done today, not very beautifully, for this is all in its infancy. Still it is obvious that here is a sturdy child.

And finally as several people have mentioned I'm convinced that over the next 10 years business will either have to take responsibility for preventing extreme economic fluctuations - extreme, not minor - or we'll see in 10 or 15 years an attempt on the part of government to do the job. And government can't do it. But, in the process of finding out that government can't do it, we may very well ruin our economy. So I see a very big job to be done, that of finding the controls which make possible the prevention of major economic fluctuations. This is primarily a job of finding the long range factors which determine capital investment and planning accordingly.

Here are some crises which I don't think are very far in the future, problems which make really good controls essential. And we don't have them. I don't think we have yet done the job that needs to be done. Here lies the greatest danger to management, and the greatest challenge to management, the greatest frontier for management.

Now, I don't have to tell anybody in this room what a good control system has to be, but I just want to list some of the specifications for the new tools we have to fashion. They are all "old hat" to you, I trust. They should be. Several people here today stressed that controls should very obviously measure something in such a way that management can take action. They are not tools of information, but tools that enable people to take action. That means the tool has to be usable the day before rather than the day after. It is focused on tomorrow's trend rather than on yesterday's mishaps. It has to be timely, it has to be fast, it has to be focused on action and it has to be focused on the things that aren't going according to the book rather than on the things that are standard. All of this is obviously "old hat". But there are two things which I would like to stress which a good many of my friends are apt to forget.

The first thing is that control is not a moral principle, but a principle of economy. In other words, the principle of control is not to prevent mistakes from happening. It is not even to find a bank cashier who dips his fingers in the till, but to obtain the maximum control with the minimum of effort. Three guys checking up on one bookkeeper - that is not control; that is strangulation. The kind of control we need is like the tiny governor on a huge machine which keeps the engine speed within a prescribed range, without any need for tremendous amounts of energy. From what I have seen we have not basically applied this concept of control, as a principle of economy, to a good many control efforts. Instead of seeing how little control is needed, we are asking what is the maximum we can put on this operation.

The second thing is that controls have to be usable. That means they have to be simple. I don't know how many of you have been in the cockpit of a modern plane. During the war one of the perennial troubles was that we could not find a balance between the need for control and the need for simplicity of control. If we cut down the number of controls to the point where two men, the pilot and the co-pilot, could actually use them, we didn't have enough control. If we put in enough controls so that they really had all the relevant information on all the things they needed, they couldn't possibly watch them because the number went up into the stratosphere. In business we are very often in the same situation. Those of us who are interested in controls come up with adequate controls without paying any attention to the question whether our boss can actually handle those 289 dials we put in front of him. Whether

he has a few other things to do, whether he has the time, whether, with due respect to him, he has the knowledge, and above all whether he has the temperament to handle all of this stuff.

Don't misunderstand me. I am not in favor of over-simplification; and some control systems are overly simplified. There is one, of which you all know, that reduces almost everything to the rate of return on the invested capital. That particular system, I think, is not really workable. In order to reduce everything to one figure you have to go through abstractions and speculations which I think are very doubtful; and on top of that as those folks have told me again and again, you have to have lived with it for 20 years before you can handle it. You have, in other words, to grow to understand what goes into it.

As another illustration, a client of mine in a highly decentralized retail operation has reduced all the controls for store managers to three: profit and loss, an employee attitude survey and the number of future management people the store manager produces. That sounds very logical. Profit and loss shows immediate performance. The company knows, or believes it knows, that its standing with the consumer, and its standing in the community is almost a direct function of employee attitude. Thus, employee attitude is really a measurement of how well the individual store manager takes care of the basic capital of the company, which is its standing with the consumer. And future management determines the future of the company. So here is a nice, balanced control system. But, it's much too simple; things aren't that simple.

So, I am not in favor of over-simplifying. I have learned two things in 15 years of consulting work. First, if a thing is so complicated that you can't explain it to the vice presidents; drop it. That is why I have been getting rid of extensive control plans, right and left; because no comptroller I know can understand them. If the folks that use them can't understand them; get rid of them. If it is that complicated, if your vice president doesn't understand it, no one else is likely to. This is not because he is so much brighter, but because he has been living with it so much longer.

The other principle, however, is: If a thing is so simplified that people believe it is simple, when it is actually very difficult; scrap it. It is just as dangerous as the over-complicated gadget and just as deceiving. So there is a problem of finding the balance between the need for simplicity, that is the need for a minimum of control, and the need to avoid obscuring the essential problems and the essential difficulties by over-simplification.

But I am not going to tell you how to do the control job. What I really want to say is that I and management depend upon what you are doing, and that I am beginning to get a little anxious because I want to get controls and need them very badly. I know the next 10 years are going to be rough years. When you are in the middle of an ocean, traveling with tremendous speed, with winds blowing from all directions; when you have a need, as we have in our economy for sudden, almost immediate, changes from war to peace and back again - that is when you need basic controls the most. That is when you really have to worry about staying on course. And that is the situation in which we are. A situation in which it is not either good judgment or particularly comforting to have to steer by the seat of your pants, as we do in many cases, because we don't have controls.

I am confident, however, that we are going to get them. The beginnings are there. Just look at the things that have been developed over the last 10 or 15 years.

Few people in this room worked on budgets twenty years ago, because the number of companies that had any such gimmick was extremely small.

We are for the first time beginning to come to grips with the problem of what are the criteria for capital investments. (Our friend, Joel Dean, who I understand was here earlier, is really a pioneer in that job. I happen to disagree with him on his principles, but that is irrelevant. The important thing is that he has tackled the problem head on. And the moment one fellow does that, all the others who don't agree with him, just jump in and wave their banners and the battle is on, and at least out of that you will get some understanding of what the problem is.) For the first time, I think as long as anybody can remember, the point is being made that we have endless procedures for capital appropriation, but have no criterion for it. When and what do you spend capital for and when do you turn down a request?

Our executive development work is to a large extent a control operation and belongs in the same area.

The concept of market analysis, which is not even 20 years old, is also a new concept of control. All of these things are new and all of these things are tremendously important. They are tools we need.

My conclusion: look upon control not as a bag of tricks, not as this tool or that tool. Do not believe that capital control is everything, or budgeting is everything, or market analysis is everything, or executive development is everything. That would be just like saying you are going to be a carpenter and never use anything but the hammer. The question is, what do we need in the tool box? We need a balanced tool box. The need today is not for refinement of this or that tool; it is for the development of a valid control program.

The need is also for people who can handle a variety of tools, rather than for people who can handle a hammer. And the need is to convince your management not that controls will eliminate their judgment but that controls will make their judgment possible and valid. Far too many managements expect that your activities will make the decisions for them. You have run up against it. Far too few know and understand that controls are not a substitute for good judgment but the foundation of judgment.

Here is an opportunity to become a specialist and at the same time obtain a broad

Those are the two jobs which I think people in this area have to do in the next 10 years. I am pretty certain they will be done, because I think the opportunity, the challenge and the excitement are so great that most of you won't be able to resist them.

business experience almost equal to that of the top executives of an organization.

NOTES ON GUEST SPEAKERS

Dr. Charles A. Bliss
Professor of Business Administration, Harvard Business School

Dr. Bliss is one of today's outstanding authorities on Management Control. Dr. Bliss was formerly Executive Secretary of the National Bureau of Economic Research and meets regularly with a group of industrial economists surveying economic factors and their impact on specific business plans. An able teacher and instructor, Dr. Bliss has exceptional knowledge on the subject of business planning.

Mr. Alvin Brown
Vice President, Johns-Manville Corp.

A Financial Officer and Director since 1946, Mr. Brown formerly served as Executive Officer of the Federal Budget and Review Officer of the National Recovery Administration. Mr. Brown is the author of two well-known books on industry and has earned a national reputation as an authority in the field of business finance and corporate organization and administration. Mr. Brown was previously associated with the West Virginia Coal & Coke Corporation as Assistant to the President.

Mr. George H. Coppers
President, National Biscuit Co.

Mr. Coppers was elected President of the National Biscuit Company when only 42 years of age. A native New Yorker, he started his notable career as an office boy, later transferring to the Accounting Office, then to the Company's Legal Department to assist in its tax matters. While with National Biscuit Company, Mr. Coppers passed the New York State Bar examination and was admitted to the practice of law. Successively, Mr. Coppers was appointed Assistant Secretary, Assistant General Counsel, General Counsel and in 1945 was elected President.

Dr. Peter F. Drucker
Author and Consultant

Dr. Drucker is consulting editor for the Research Institute of America and a Professor of Management at the Graduate Business School at New York University. The author of several books, Dr. Drucker is a regular contributor to such magazines as "Harpers", "Fortune", "The Saturday Evening Post" and the "Harvard Business Review".

Dr. Dexter M. Keezer
Director of the Department of Economics, McGraw-Hill Publishing Co.

Formerly Deputy Administrator of the Office of Price Administration, Economic Advisor of the Mission for Economic Affairs in London, England, and Public Member of the National War Labor Board, Dr. Keezer possesses a background of government and business experience and accomplishments. Prior to World War II, while President of Reed College in Portland, Oregon, Dr. Keezer served as a member of several emergency boards to deal with threatened railroad strikes and labor problems in the lumber in-

dustry. Dr. Keezer is the author of many books dealing with business and economics.

Dr. William D. Knight
Associate Professor of Commerce, University of Wisconsin

Dr. Knight, as Director of Business Research and Service of the University of Wisconsin, has lectured and published many articles on business and financial subjects. His analytical ability and training makes Dr. Knight one of the foremost professors in the field of financial research. Dr. Knight was formerly connected with the Taylor-Freezer Corporation as General Assistant to the President and is a member of the American Association of University Professors.

Mr. Hamilton Merrill
President, Manning, Maxwell and Moore, Inc.

Mr. Merrill rose to the Presidency of Manning, Maxwell and Moore, Inc., after being associated with the company since 1920. His diversified and long business experience enables him to vividly present Management's concept of its future problems and plans. Mr. Merrill was formerly associated with American Steam Gauge and Valve Mfg. Company, American Schaeffer and Budenburg Corp. and Consolidated Ashcroft Hancock Company. Mr. Merrill is a trustee of the Bridgeport Peoples Savings Bank and a Director of the Bridgeport City Trust Company.

Mr. John R. Sargent
Partner, Cresap, McCormick & Paget

Mr. Sargent has been a partner of one of the country's leading management engineering companies since 1949. Formerly Manager of Market Research & Development for Westinghouse Electric Corporation and Vice President and Director of George S. Armstrong & Company, Mr. Sargent is a recognized authority on sales and marketing analyses.

Mr. Q. Forrest Walker
Economist, R. H. Macy & Co.

Author and lecturer on distribution, finance and fair trade laws, Mr. Walker is one of the noted economists in his field. His judgment and advice on corporate finance and investments are widely sought and his knowledge of economic trends particularly qualifies him to portray business markets of the future. Mr. Walker is also a director and secretary of Macy's Bank and for many years was economist, tax consultant and investment advisor of the National City Co. of New York.

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